

An Overview of the Nonprofit and Charitable Sector

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Summary

A number of policy issues have direct or indirect consequences for the nonprofit and charitable sector, including the establishment of a social innovation initiative, changes in the tax treatment of charitable donations, responses to the economic downturn, and health care reform. The nonprofit and charitable sector represents a significant portion of the U.S. economy. The sector is also highly diverse. Having a greater understanding of the nonprofit and charitable sector as a whole may help policymakers evaluate proposals that may impact the sector.

The first section of this report provides a formal definition of the nonprofit and charitable sector. The term “nonprofit sector” is generally intended to refer to organizations with federal tax-exempt status; “charitable sector” refers to the subset of these organizations that have 501(c)(3) public charity status.

The next section reports on the size and scope of the charitable sector. Charitable organizations are estimated to employ more than 7% of the U.S. workforce, while the broader nonprofit sector is estimated to employ 10% of the U.S. workforce. In 2009, the charities filing Form 990 with the Internal Revenue Service reported approximately \$1.4 trillion in revenue and reported holding nearly \$2.6 trillion in assets. Nonprofit institutions serving households (largely charities) constituted more than 5% of GDP in 2008.

The third section of this report examines how charities are funded. Revenue comes from a variety of sources, including private contributions, payments (fees for service), government grants, and investment income. Revenue sources vary significantly across different types of charities: charities involved in health care (including nonprofit hospitals) and educational institutions rely heavily on private payments while arts, culture, and humanities charities and environment and animals charities are more reliant on private contributions. Private contributions to charities are of particular interest as charitable giving may respond to changes in the tax code. As the recent economic downturn has increased the demand for goods and services provided by a number of charities, the impact of the business cycle on funding is also discussed.

The fourth section provides an overview of the charitable sector’s relationship with government. From a theoretical perspective, economics suggests that the government should subsidize activities that are either public goods or have positive external effects. It can be argued that some charitable activities possess these qualities. The costs to the government of providing grants, allowing charitable contributions to be tax deductible, exempting investment income of charities from tax, and providing property and sales tax exemptions are presented. The oversight role of the government is also reviewed.

Finally, the report concludes with policy considerations. This section opens by surveying what policy options are considered most important by charitable organizations themselves. Building on this, a number of policy options are examined, including (1) increasing government grants and subsidies to charitable organizations; (2) creating an oversight agency within the federal government to gather data, conduct research, and advocate for the charitable sector; (3) implementing policies designed to help charities and foundations in economic downturns; (4) changing the itemized deduction for charitable contributions by limiting, converting to a credit, or making the deduction more widely available; and (5) a variety of other tax issues.

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As this report illustrates, the nonprofit and charitable sector represents a significant, highly diverse component of the U.S. economy. Currently, there are a number of policy issues that could affect, either directly or indirectly, the structure and functioning of nonprofit and charitable organizations. President Barack Obama has turned toward the nonprofit sector while seeking solutions to social problems via the Social Innovation Fund.¹ The recent economic downturn increased the demand for many of the goods and services provided by charitable organizations, while simultaneously placing the same organizations under increased financial constraints. The treatment of nonprofits in health care reform has also been a major issue, as the tax code cannot provide the same incentives to nonprofits (nonprofit health care providers and nonprofit employers providing insurance) that are available to for-profit organizations. Finally, the tax treatment of nonprofits and their contributors raises issues of efficiency, equity, and fairness.

To assist policymakers in evaluating reforms that will potentially affect nonprofit and charitable organizations, this report provides a broad overview of the charitable sector. Such context and background information will help policymakers determine if the government's current relationship with the nonprofit and charitable sector is efficient, or if there are policy changes that could lead to a better use of resources.

This report begins by defining the nonprofit and charitable sector. It is especially important to understand the distinction between nonprofit and charitable organizations. While the term nonprofit tends to be used loosely in the literature, nonprofit here is used to identify the broad array of organizations with federal tax-exempt status. Charitable organizations are defined as organizations with 501(c)(3) public charity status, and are a subcategory of the broader nonprofit sector.

The second section provides an overview of the charitable sector, focusing specifically on employment within the sector, as well as revenue and assets of charitable organizations. The charitable sector's role in the broader economy is evaluated by comparing the charitable sector to other major industrial sectors.

Third, the finances of charitable organizations are explored. Specifically, various revenue sources, both government and nongovernment, are examined. The amount of revenue coming from private contributions, government grants and transfers, private payments, and investment income is identified. The differences in revenue sources across charitable sectors are also analyzed. Finally, the impact of the economic downturn on revenue for charitable organizations is briefly addressed.

The fourth section reviews the relationship between the charitable sector and government. To evaluate the relationship between the charitable sector and the federal government, the economic rationale for subsidizing charities is presented. After presenting the theoretical underpinnings for interaction between charities and government, direct evidence on the cost of the relationship as it presently exists is discussed.

Finally, the report concludes with policy considerations and options. The policy options are framed by examining policy issues deemed important by nonprofit and charitable organizations. The possibility of increasing support through grants and subsidies, introducing an oversight agency within the federal government, and revising the rules on itemized deductions for charitable organization are explored.

¹ The White House: Office of the Press Secretary, "President Obama to Request \$50 Million to Identify and Expand Effective, Innovative Nonprofits," press release, May 5, 2009.

The Nonprofit and Charitable Sectors²

This report analyzes data relating to the nonprofit and charitable sectors. For purposes of this report, the term “nonprofit sector” is generally intended to include all organizations with federal tax-exempt status.³ The term “charitable sector” is used to refer to one type of tax-exempt organization, specifically those organizations with 501(c)(3) public charity status.

The Internal Revenue Code (IRC) describes approximately 30 types of tax-exempt organizations.⁴ Examples include charitable organizations, social welfare organizations, labor unions, trade associations, fraternal societies, and political organizations.

The largest category, and the primary focus of this report, are the organizations described in Internal Revenue Code (IRC) Section 501(c)(3). Organizations eligible for 501(c)(3) status include charities, religious organizations, hospitals, and educational institutions.⁵ The entire universe of these organizations is commonly referred to as “charitable organizations.”

Every 501(c)(3) organization is classified as either a “public charity” or “private foundation.” Public charities have broad public support and tend to provide charitable services directly to the intended beneficiaries. Private foundations often are tightly controlled, receive significant portions of their funds from a small number of donors or a single source, and make grants to other organizations rather than directly carry out charitable activities. 501(c)(3) organizations are presumed to be private foundations unless they qualify for public charity status based on support and control tests.

IRS Filing Requirements

A primary source for some of the data contained in this report is Form 990, which is the annual information return that must be filed with the IRS by most tax-exempt organizations. Form 990 collects information about the organization’s finances, assets, and activities.

For tax year 2009, public charities with gross receipts of at least \$500,000 or total assets of at least \$1.25 million must file the regular Form 990, while public charities with gross receipts between \$25,000 and \$500,000 and total assets of less than \$1.25 million may file the Form 990-EZ. Public charities whose gross receipts normally do not exceed \$25,000 file the Form 990-N

² Erika Lunder, Legislative Attorney, wrote this section of the report.

³ While this report generally uses the terms “tax-exempt organization” and “nonprofit organization” interchangeably, it should be noted that this might not be appropriate in other contexts. The term “tax-exempt organization” refers to organizations with federal tax-exempt status. The term “nonprofit organization” is often used simply to refer to an entity that is not intended to be a profit-making corporation. The term can be more precisely understood to mean an entity organized under the laws of a state, with its status and privileges determined under state law. Because the qualifications for nonprofit status vary among states, it is possible for the term “nonprofit organization” to be broader than, narrower than, or identical to the term “tax-exempt organization.” For a nonprofit organization to be exempt from federal income taxes, it must meet the statutory requirements found in the Internal Revenue Code and usually must file an application with the IRS. Some organizations, including small 501(c)(3) organizations and qualifying religious organizations, are exempt from the application requirement.

⁴ For more information on tax-exempt organizations, see CRS Report 96-264, *Frequently Asked Questions About Tax-Exempt Organizations*, by Erika K. Lunder and CRS Report RL30877, *Characteristics of and Reporting Requirements for Selected Tax-Exempt Organizations*, by Erika K. Lunder.

⁵ IRC § 501(c)(3) describes organizations “organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition ... or for the prevention of cruelty to children or animals.” Among other requirements, “no part of the net earnings of” the organization may “inure to the benefit of any private shareholder or individual.”

(“e-Postcard”), which only requires basic identifying information such as the names and addresses of the organization and a principal officer. Private foundations file using the Form 990-PF. Churches and other qualifying religious organizations are exempt from the annual information-reporting requirements.

In addition to the information return, there are other situations when tax-exempt organizations must file a tax return. For example, tax-exempt organizations are subject to tax on income from business activities unrelated to their exempt purpose. Organizations subject to this tax, known as the unrelated business income tax (UBIT), must file a tax return using the Form 990-T.

Additionally, tax-exempt organizations must generally pay the same employment taxes (i.e., withhold income and payroll taxes of their employees) as for-profit employers and file the applicable returns. Finally, an organization’s activities might require it to file other returns, such as an excise tax return.

Table 1 presents information on the number of nonprofit and charitable organizations as of July, 2009. Of the 1.5 million registered nonprofit organizations, nearly 64% are public charities. Nearly 8% are private foundations, while 29% are other types of nonprofits. Only 52% of registered charities file Form 990. Non-filers include qualifying religious organizations, small organizations, and organizations that may no longer exist but have not been removed from the IRS Business Master File (BMF). Very little information is available regarding non-filing organizations.

Table 1. Registered and Filing Nonprofit Organizations by Organization Type

	Number of Registered Organizations	Share of Total Registered Organizations	Number of Organizations Filing Form 990	Share of Total Filing Organizations
Public charity	986,553	63.5%	512,689	58.6%
Private foundation	115,958	7.5%	86,591	9.9%
Other nonprofit	450,151	29.0%	275,420	31.5%
Unknown	1,615	0.1%	894	0.1%

Source: IRS Business Master File (BMF) (July 2009), Urban Institute National Center for Charitable Statistics (NCCS)

Notes: Registered organizations are those registered as having tax-exempt status with the IRS. Filing organizations are those that filed Form 990 (including 990EZ and 990PF) within 24 months of the July 2009 release date, as reported in NCCS Core Files and IRS Business Master Files.

Size and Scope of the Nonprofit and Charitable Sectors

Employment

Measuring employment in the nonprofit and charitable sector is not an easy task. There is no government agency that regularly collects systematic employment data on the nonprofit sector.⁶

⁶ Organizations are required to provide some employment data on the Form 990. This data is collected at the organization level, rather than establishment level, making it difficult to make geographic distinctions for nonprofit and

There are two major studies that have attempted to measure employment in the nonprofit and charitable sector in recent years. Their results are presented in **Table 2** and **Table 3** below. The first is employment in the nonprofit sector. In 2005, the estimated total employment in the nonprofit sector was 12.9 million. The second is employment in the charitable sector. The estimated number of paid workers employed by charities in 2004 was 9.4 million. At the end of 2004, there were 132.5 million employees nationwide.⁷ Nearly 10% of America's workforce works in the nonprofit sector, with more than 7% of the workforce employed by charities.

Table 2 provides estimates of nonprofit employment by industry. More than half of nonprofit employment (approximately 54%) is involved in health care and social assistance. In 1998, nearly 23% of nonprofit employees were involved in other services. This proportion fell by 2005 to just over 21%. In both 1998 and 2005, approximately 18% of nonprofit employees provided educational services. Arts, entertainment, and recreation was the fourth largest category, with nearly 4% of all nonprofit employment within this category.

Table 2. Nonprofit Employment by Industry

NAICS Code	Industry	1998	1998 Share	2005	2005 Share	% Change 1998 - 2005
11	Agriculture, forestry, fishing, and hunting	11,900	0.1%	12,211	0.1%	2.61%
22	Utilities	4,131	0.0%	6,875	0.1%	66.42%
48, 49	Transportation and warehousing	1,272	0.0%	1,833	0.0%	44.10%
51	Information	32,354	0.3%	36,602	0.3%	13.13%
52	Finance and insurance	72,829	0.7%	86,548	0.7%	18.84%
53	Real estate and rental and leasing	2,986	0.0%	2,910	0.0%	-2.55%
54	Professional, scientific, and technical services	119,255	1.1%	167,560	1.3%	40.51%
56	Administrative and waste management services	25,311	0.2%	21,476	0.2%	-15.15%
61	Educational services	1,972,039	17.8%	2,335,466	18.1%	18.43%
62	Health care and social assistance	5,941,902	53.5%	6,999,312	54.2%	17.80%
71	Arts, entertainment, and recreation	403,242	3.6%	481,755	3.7%	19.47%
72	Accommodation and food services	12,730	0.1%	17,902	0.1%	40.63%
81	Other services, except government	2,500,681	22.5%	2,751,202	21.3%	10.02%
	Total	11,100,632		12,921,652		16.40%

Source: Estimated employment levels are from Kennard T. Wing, Thomas H. Pollak, and Amy Blackwood, *The Nonprofit Almanac 2008* (Washington, DC: The Urban Institute Press, 2008).

Notes: The employment levels here were estimated using data from the 2002 Economic Census conducted by the U.S. Census Bureau, the U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts from 2007, the U.S. Department of Labor, Bureau of Labor Statistics, Quarterly Census of Employment and Wages spanning 1998 through 2007, the Urban Institute's National Center for Charitable

charitable workers. Further, a number of organizations fail to report their number of employees. The data is self-reported by the organization and may contain errors.

⁷ Total nonfarm payroll for all employees is collected by the U.S. Department of Labor: Bureau of Labor Statistics.

Statistics Core Files from 1998 through 2006, and the IRS Statistics of Income Form 990 and 990-EZ Sample Files from 1998 through 2006. The NAICS Code is the North American Industrial Classification System. Shares may not sum to 100% due to rounding.

Between 1998 and 2005, employment in the nonprofit sector grew by an estimated 16.4%. Overall, nationwide growth in employment was approximately 6.2%.⁸ While the utilities; transportation and warehousing; accommodation and food services; and professional, scientific, and technical services sectors experienced the most growth between 1998 and 2005, each of these four sectors still represents less than 1% (1.3% for the professional, scientific, and technical services) of total nonprofit employment. The first and third largest sectors in terms of nonprofit employment—health care and social assistance and education services, respectively—experienced increases in employment that exceeded employment increases for the nonprofit sector as a whole.

The second employment estimate is that of the number of persons employed by the charitable sector. **Table 3** presents 2004 estimates of employment by charities across various sectors.

⁸ CRS calculations based on total nonfarm payroll for all employees, U.S. Department of Labor: Bureau of Labor Statistics.

Table 3. Employment in the Charitable Nonprofit Sector

NAICS Code	Industry	2004	Share of Charitable Employment
51	Information	71,000	0.8%
52-53	Finance, insurance, and real estate	76,000	0.8%
54	Professional, scientific, and technical services	250,000	2.7%
61	Educational services	1,373,000	14.6%
62	Health care and social assistance	6,518,000	69.5%
71	Arts, entertainment, and recreation	243,000	2.6%
81	Other services, except government	695,000	7.4%
	Total	9,385,000	

Source: Lester M. Salamon and S. Wojciech Sokolowski, *Employment in America's Charities: A Profile*, The Johns Hopkins Center for Civil Society Studies, Nonprofit Employment Bulletin Number 26, December 2006.

Notes: Note that the total is not the sum of individual fields. This is attributable to data disclosure limitations. These estimates were made using data from the U.S. Bureau of Labor Statistics' Quarterly Census of Employment and Wages (QCEW). Since many states only require nonprofit organizations with at least four employees to respond to the QCEW, the numbers reported here likely understate total employment in the charitable sector. The data report employment from the second quarter of 2004. Shares may not sum to 100% due to rounding.

Generally, the estimates of employment in the charitable sector are consistent with estimates for total employment by nonprofits.⁹ Since charities are a subset of nonprofits, it is expected that there would be fewer persons employed by charities as compared to nonprofits.

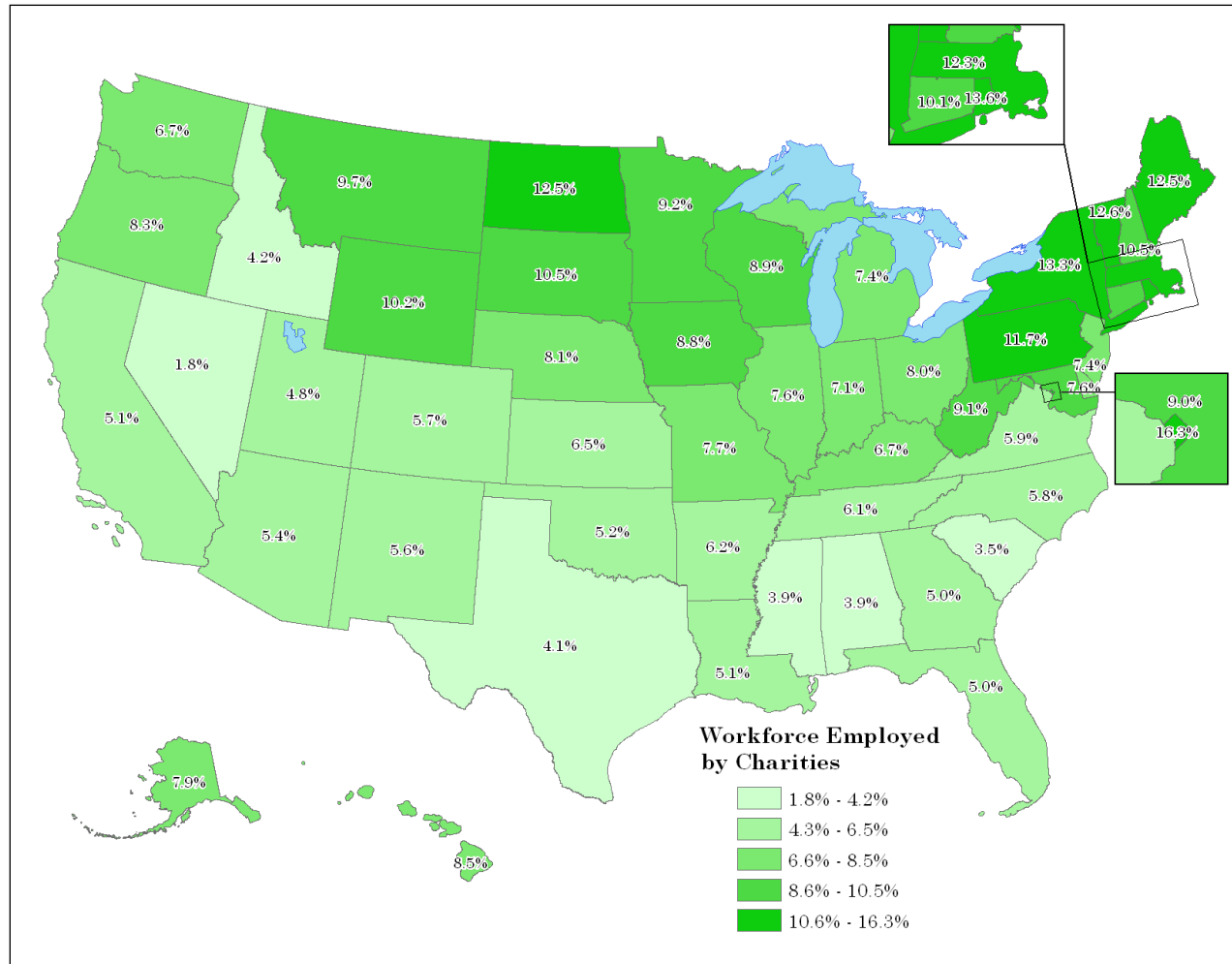
Figure 1 depicts regional variation with respect to the percentage of the workforce employed by the charitable sector. In relative terms, the northeast tends to see a larger proportion of its workforce employed by the charitable sector. The District of Columbia has the largest proportion of workers employed by the charitable sector, with 16.3%. In Rhode Island, 13.6% of workers are employed by a charitable organization. New York ranks third when ranking states by employment in the charitable sector, with 13.3%. Relative to other parts of the country, fewer persons are employed by the charitable sector in the south.

In addition to paid workers, volunteer workers make up a significant portion of the labor involved in providing charitable goods and services. In 2004, there were an additional 4.7 million full-time equivalent (FTE) volunteer workers employed by charitable institutions.¹⁰ **Figure 2** depicts FTE volunteers as a percentage of total employment in each state. While states in the northeast tend to have a larger proportion of workers employed in the charitable sector, a similar pattern does not appear for volunteers as a share of total employment. In fact, there is very little (if any) relationship between the proportion of workers employed by the charitable sector and volunteers relative to total employment.

⁹ Kennard T. Wing, Thomas H. Pollak, and Amy Blackwood, *The Nonprofit Almanac 2008* (Washington, DC: The Urban Institute Press, 2008) explicitly discusses the methodologies used for estimating employment in the nonprofit sector.

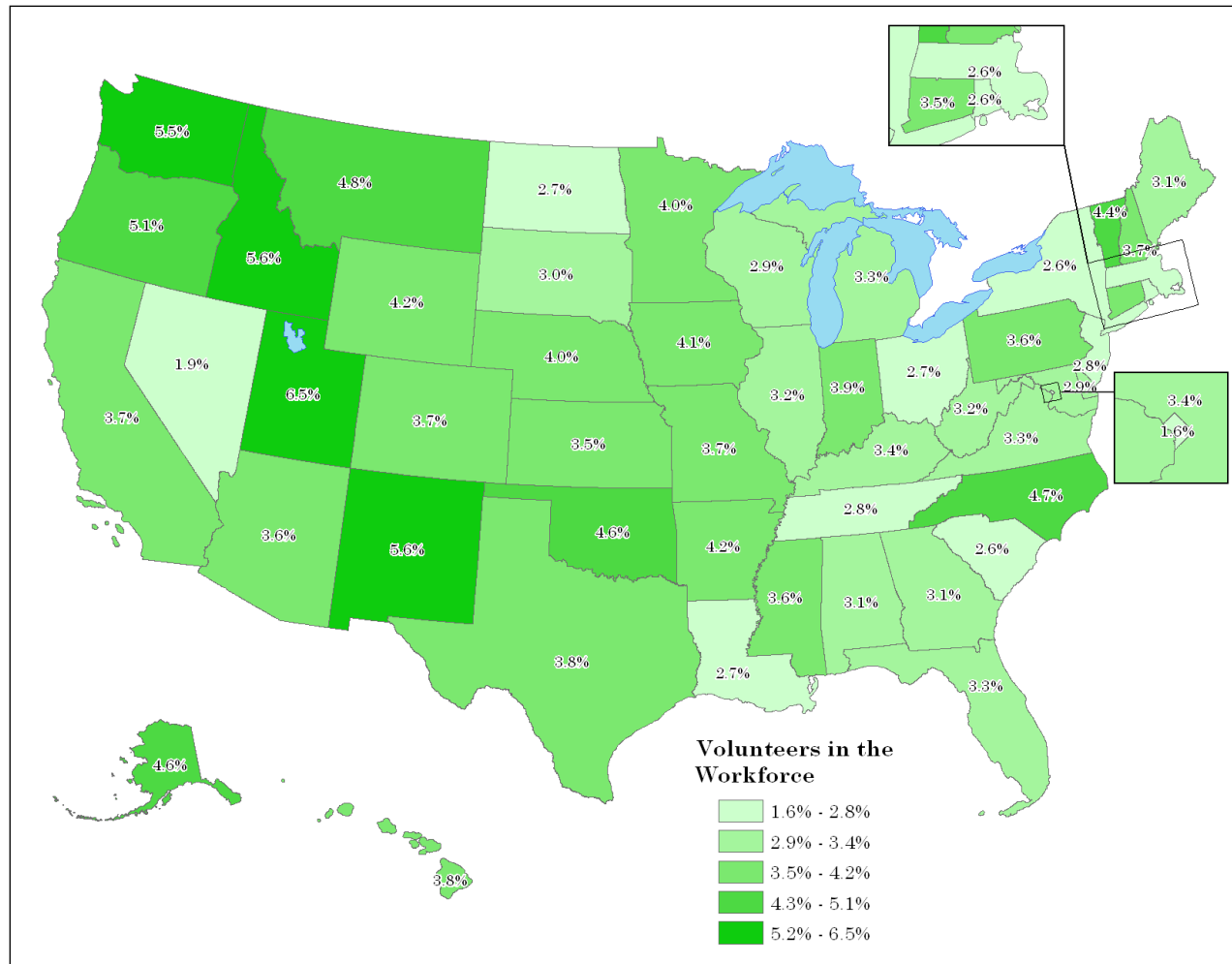
¹⁰ Salamon and Sokolowski, *Employment in America's Charities: A Profile*, The Johns Hopkins Center for Civil Society Studies, Nonprofit Employment Bulletin Number 26, December 2006.

Figure I. Share of Workers in Each State Employed by the Charitable Sector, 2004



Source: CRS calculations based on data from Salamon and Sokolowski (2006). Percentage of paid workers employed by the charitable sector in 2004.

Figure 2. Full-Time Equivalent Volunteers as Percent of Workforce, 2004



Source: CRS calculations based on data from Salamon and Sokolowski (2006). Percentage of full-time equivalent volunteer workers employed by the charitable sector in 2004.

Revenue

Table 4 reports the revenue of 501(c)(3) public charities reporting as of July 2009. For charities filing Form 990, total revenues for 2009 are \$1.40 trillion. Revenue information is provided by 512,889 public charities filing Form 990 with the IRS. The revenue raised differs significantly across sectors. For example, nonprofit hospitals that are charitable organizations are less than 1% of all filing organizations. Yet amongst revenues for filing charitable organizations, 41% is reported by hospitals. More than 29% of assets held by filing charitable organizations are held by hospitals.

Charitable hospitals receive the largest share of revenue. Other health-orientated charitable organizations are also responsible for a relatively large share of revenue flowing into the charitable sector, more than 15%. Given that 9.6% of filing organizations are health organizations, the fact that these organizations bring in 15% of revenue is closer to being proportional.

The higher-education sector, like the hospital sector, generates a highly disproportionate level of revenue and holds a disproportionate quantity of assets. While only 0.5% of charities are higher-education organizations, higher-education organizations generate more than 11% of revenue flowing to charitable organizations and hold more than 21% of the charitable sector's assets. These data suggest that while higher-education and hospital charitable organizations are relatively few in number, they are a very large part of the charitable sector in terms of revenue and assets.

Charitable organizations focusing on providing goods and services in the realm of arts, culture, and humanities tend to have below-average revenue. While more than 12% of charitable organizations filing Form 990 are in the arts, culture, and humanities category, the sector only generates 2.3% of total revenue flowing into the charitable sector. In terms of revenue, arts, culture, and humanities charities are markedly smaller than health and education charitable organizations. Charitable organizations with a focus on the environment, human services, and the public benefit also tend to be smaller, as evidenced by the fact that these sectors represent a larger share in the number of organizations than the sectors' share in revenue generation or asset holdings.

The data in **Table 4** also highlight the limited amount of information reported by religious charitable organizations. While 22.6% of registered charitable organizations are religious organizations, only 6.5% of organizations filing 990 are religious charities. Since religious organizations are not required to file Form 990, very little is known about the revenue generated and assets held by religious charities.

Table 4. Charitable Organizations by Group: Revenue & Assets
(billions of dollars)

NTEE Group	# of Registered Organizations		# of Organizations Filing 990		Total Revenue		Total Assets	
Arts, Culture, and Humanities	99,263	10.06%	64,347	12.55%	32.67	2.34%	100.39	3.86%
Education	149,411	15.14%	91,113	17.76%	97.84	6.99%	303.68	11.68%
Higher Education	4,177	0.42%	2,378	0.46%	158.94	11.36%	551.22	21.21%
Environment	45,882	4.65%	24,924	4.86%	13.73	0.98%	33.05	1.27%
Health	72,410	7.34%	49,357	9.62%	216.16	15.45%	256.06	9.85%
Hospitals	6,384	0.65%	4,822	0.94%	577.06	41.25%	757.08	29.13%
Human Services	261,984	26.54%	163,885	31.95%	175.50	12.55%	268.79	10.34%
International, Foreign Affairs, and National Security	14,781	1.50%	9,361	1.83%	30.80	2.20%	31.65	1.22%
Public and Societal Benefit	107,946	10.94%	65,835	12.84%	81.33	5.81%	254.61	9.80%
Religion Related, Spiritual Development	213,574	21.64%	33,110	6.46%	12.14	0.87%	26.68	1.03%
Mutual/Membership Benefit Organizations, Other	2,521	0.26%	1,617	0.32%	2.49	0.18%	15.07	0.58%
Unknown	8,700	0.88%	2,140	0.42%	0.30	0.02%	0.64	0.02%
Total	987,033	100.00%	512,889	100.00%	1,398.95	100.00%	2,598.92	100.00%

Source: The Urban Institute, National Center for Charitable Statistics, <http://nccsdataweb.urban.org/> and Internal Revenue Service, Exempt Organizations Business Master File (July 2009).

Notes: Revenue and assets are for organizations that filed Form 990 or Form 990EZ within 24 months of the July 2009 Business Master File release date. Organizations are grouped according to the National Taxonomy for Exempt Entities (NTEE), a system for categorizing the activities of nonprofit organizations established by the National Center on Charitable Statistics. Registered organizations are those appearing in the Business Master File. Revenue and assets are for filing organizations only.

Assets

Table 4 also reports total assets across different types of public charities. Charities reporting as of July 2009 held \$2.6 trillion worth of assets. These assets are held by the 512,899 public charities filing Form 990. As was seen with respect to revenue, asset holding patterns vary across charitable sectors.

Charities in the education sector stand out when examining asset holdings. Specifically, education charities hold nearly 33% of assets held by charitable institutions, while only 18% of charitable organizations filing Form 990 are in the education sector. Relative to other types of charities, education charities hold more assets. This observation is driven by asset holdings of higher-education institutions, and the large asset holdings in the endowments of some of these institutions.

Health-related charities also hold a disproportionate volume of assets relative to the number of organizations in the health sector, while charities in the human services and housing sectors hold a share of assets that is less than their share of filing organizations. Specifically, health charities hold nearly 36% of assets while only 5.5% of charitable organization filing Form 990 are in the health sector. More than 10% of charities filing Form 990 are in the human services sector, yet the human services sector holds less than 6% of charitable organizations' assets. Housing charities are another sector where the share of assets held is relatively low. Nearly 4% of all charitable organizations filing Form 990 are in the housing sector yet the housing sector only holds 2.5% of all charitable organizations' assets.

One important point to note when examining the revenue and asset data presented in **Table 4** is that there is no adjustment or control for charity size. Revenue and assets for the health and education sectors are relatively high, reflecting in part their tendency to be larger than other types of charities. Health charities, for example, averaged \$26.5 million in revenue and \$33.3 million in assets. Arts, culture, and humanities organizations are much smaller, with the average institution in this sector generating \$0.5 million in revenue and holding \$1.6 million in assets. Charitable sectors that tend to have organizations smaller in size hold a lesser share of the charitable sectors' total revenue and assets.

Revenue and Assets in the Broader Nonprofit Sector

Table 5 contains information on the assets and revenue for public charities relative to private foundations and other nonprofits. While public charities represent approximately 59% of nonprofit organizations filing Form 990, charities bring in 71% of revenue, a disproportionately large share. Nearly 10% of nonprofit organizations filing Form 990 are private foundations. Private foundations hold a disproportionate amount of assets, with nearly 15% of nonprofit assets held by foundations. While nearly 32% of nonprofits are neither charities nor foundations, less than 20% of revenue and 24% of assets are held by these other nonprofits.

Table 5. Total Revenue and Assets by Nonprofit Type
(billions of dollars)

	Number of Organizations Filing Form 990	Share of Total Filing Organizations	Total Revenue Reported on Form 990	Share of Total Revenue	Total Assets Reported on Form 990	Share of Total Assets
Public charity	512,689	58.6%	\$1,397	71.1%	\$2,598	61.3%

	Number of Organizations Filing Form 990	Share of Total Filing Organizations	Total Revenue Reported on Form 990	Share of Total Revenue	Total Assets Reported on Form 990	Share of Total Assets
Private foundation	86,591	9.9%	\$181	9.2%	\$621	14.7%
Other nonprofit	275,420	31.5%	\$386	19.7%	\$1,014	23.9%
Unknown	894	0.1%	\$1	0.1%	\$2	0.1%
Total	875,594	100%	\$1,966	100%	\$4,236	100%

Source: IRS Business Master File (BMF) (July 2009), Urban Institute National Center for Charitable Statistics (NCCS).

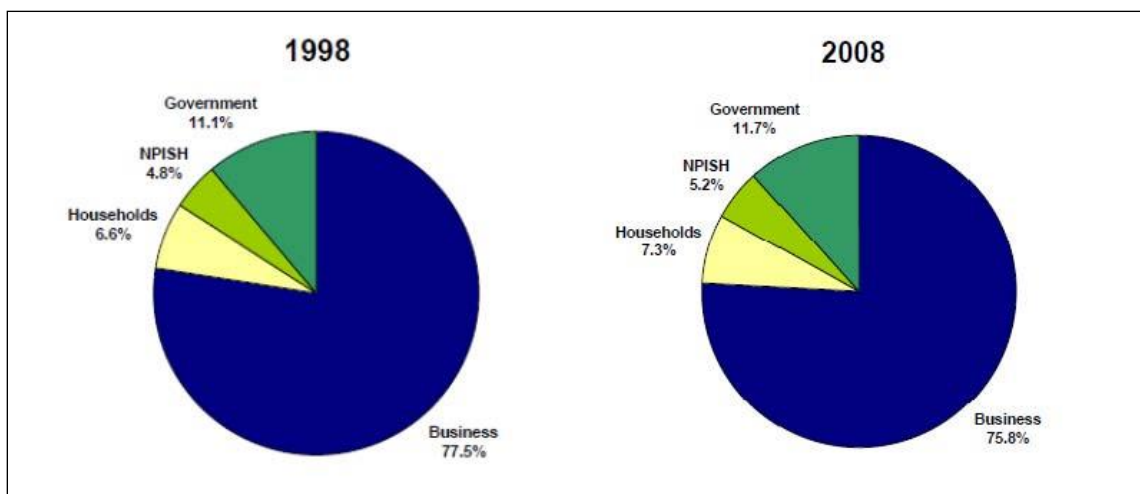
Notes: Filing organizations are those that filed Form 990 (including 990EZ and 990PF) within 24 months of the July 2009 release date, as reported in NCCS Core Files and IRS Business Master Files. Columns may not sum due to rounding.

Contribution of Charities to GDP

To evaluate the contribution of nonprofits and charitable organization to total output, data from the agency charged with measuring the size of the U.S. economy, the Bureau of Economic Analysis of the Department of Commerce (BEA), is utilized. As illustrated in **Figure 3**, in 2008 nonprofit institutions serving households (NPISH) were responsible for generating 5.2% of U.S. GDP, or \$751.2 billion worth of output.¹¹ The share increased 0.4 percentage points between 1998 and 2008.¹² Nonprofits' share of output consists of wages paid to nonprofit employees, the rental value of assets owned and used by nonprofits while providing services, and rental income from tenant-occupied housing owned by nonprofits.

¹¹ Nonprofit institutions serving households (NPISH) are tax-exempt organizations that provide services in one of the following five areas: (1) religion and welfare, including social services, grant-making foundations, political organizations, museums and libraries, and some civic and fraternal organizations; (2) medical care; (3) educational and research institutions; (4) recreation, including cultural and athletic organizations; and (5) personal business, including labor unions, legal aid, and professional associations. See Charles Ian Mead, Clinton P. McCully, and Marshall B. Reinsdorf, *Income and Outlays of Households and of Nonprofit Institutions Serving Households*, Bureau of Economic Analysis, April 2003, <http://www.bea.gov/scb/pdf/2003/04april/0403household.pdf>.

¹² Examination of the data underlying **Figure 3** supports the finding that the increase in NPISH's share of GDP is representative of a trend rather than an anomaly.

Figure 3. Nonprofit Institutions Serving Households' Share of GDP

Source: CRS calculations based on U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts Tables, Table 1.3.5.

Notes: Shares determined using Gross Value Added by Sector.

While the Bureau of Economic Analysis's data provide the best representation of the nonprofit sector's share in the economy, some care should be taken in interpretation. First, the NPISH classification represents a subset of all nonprofits, and therefore represents a share of economic activity smaller than that of the entire nonprofit sector. The NPISH classification also is not synonymous with what is typically thought of as the charitable sector 501(c)(3) organizations. Social welfare organizations and labor unions, for example, may be included in the BEA's NPISH category but are not 501(c)(3) charitable organizations. On the other hand, some 501(c)(3) organizations may not fall within the NPISH classification, such as those that sell goods or services in a manner similar to businesses. Overall, it is likely that the NPISH's share in GDP is greater than that of the charitable sector, but less than that of the nonprofit sector.

Other cautions include the fact that there are difficulties in placing a value on much of the output of charitable organizations. Since pricing the value of charitable output is difficult, the BEA estimates the value of output by using the cost of the inputs. Determining the cost of inputs, however, presents its own set of problems. Employee wages are the largest component of charitable organizations' costs. As was noted above, the data on the number of employees in the charitable sector are not precise. A final issue is the fact that the BEA's method for measuring the nonprofit sector's output only includes measurable costs of inputs. However, many nonprofit and charitable organizations are supported via volunteer efforts. Since these efforts do not represent a cost they are not included in the measure of output.

The Nonprofit & Charitable Sectors vs. Other Major Economic Sectors

To compare the size of the nonprofit sector to other major economic sectors, employment levels are examined. As was noted above, there were nearly 13 million nonprofit employees in 2005, and an estimated 9.4 million employees in the charitable sector in 2004. **Table 6** presents employment in selected industries in 2005.¹³ In terms of employment, the charitable sector is

¹³ The nonprofit or charitable sector and the industrial sectors listed in **Table 6** are not mutually exclusive. For

larger than the construction sector. The charitable sector is also larger than the finance and insurance, and real estate sectors combined when size is measured by employment. The charitable sector has nearly half as many employees as the government, where the government includes all federal, state, and local government employees.

Table 6. Employment by Industrial Sector, 2005
(thousands)

Industrial Sector	2005 Employment
Construction	7,353
Manufacturing	13,954
Retail Trade	13,467
Finance and Insurance	5,829
Real estate and rental and leasing	2,004
Educational Services	2,543
Health care and social assistance	13,258
Government	19,872

Source: Bureau of Economic Analysis, Table 6.5D, Full-Time Equivalent Employment by Industry.

Notes: The government sector includes federal government employees, both civilian and military. The government sector also includes state and local government employment, including those involved in providing education.

Table 7 provides the contributions of various economic sectors to GDP. As was illustrated in **Figure 3**, nonprofit institutions serving households (NPISHs) represented 5.2% of GDP, or \$751.2 billion in 2008. In terms of contribution to GDP, NPISHs are a larger part of the economy than the construction sector and the educational services sector.¹⁴ NPISHs contribute nearly half as much to GDP as the manufacturing sector.

Table 7. Contribution to GDP by Industry
(billions of dollars)

Industrial Sector	Value Added	Share of GDP (%)
Construction	581.5	4.1
Manufacturing	1,637.7	11.5
Retail trade	885.5	6.2
Finance and insurance	1,064.9	7.5
Real estate and rental and leasing	1,783.5	12.5
Educational services	138.3	1.0
Health care and social assistance	1,019.7	7.2
Government	1,840.0	12.9

example, the educational services and health care and social assistance sectors have many employees that are also counted as being employed in the charitable sector.

¹⁴ This does not include education provided by state and local governments.

Source: Bureau of Economic Analysis, Gross Domestic Product by Industry Accounts, Value Added by Industry, 2008.

Drawing conclusions regarding the importance of the charitable sector in the economy depends critically on what is being measured. When looking at employment figures, the charitable sector appears to be larger than the construction, manufacturing, finance and insurance, real estate and rental and leasing, and educational services sectors. However, only the construction and educational services sectors had contributions to GDP below the contributions of NPISHs in 2008. Further, direct comparison of the data presented on the nonprofit and charitable sectors' employment to NPISHs contribution to GDP is not appropriate since NPISHs, by definition, are not all charitable organizations nor all nonprofit organizations.

To gain further perspective on the relative size of nonprofit organizations, **Table 8** compares the distribution of employees at the establishment level of nonprofit firms to establishments in the financial services and real estate industry and to establishments across all industries. While establishment data do not provide information regarding the overall size of nonprofit firms to for-profit firms, the establishment data do allow for a couple of observations. First, relatively speaking, there are fewer very large establishments in the nonprofit sector. Only 6% of nonprofit establishments have more than 1,000 employees on site, while 14.6% of all establishments (for-profit and nonprofit) have more than 1,000 employees on site. In the financial services and real estate sector, 27.2% of establishments have 1,000 or more employees. Second, there are fewer very small establishments in the nonprofit sector than in all sectors taken together. While 52% of nonprofit establishments have less than 10 employees, 58.1% of all establishments have less than 10 employees. In the financial services and real estate sector, 51% of establishments have less than 10 employees. Nonprofit establishments are more likely than the typical establishment to be mid-sized, with more than 10 but less than 1,000 employees.

Table 8. Distribution of Employment by Establishment, 2008

Number of Employees	Distribution of Nonprofit Establishments (%)	Distribution of Financial Services and Real Estate Establishments (%)	Distribution of Total Establishments (%)
Less than 10	52.0	51.0	58.1
10-24	13.2	6.0	12.1
25-99	12.5	5.5	8.2
100-999	16.3	10.3	8.8
Greater than 1,000	6.0	27.2	14.6

Source: Medical Expenditure Panel Survey, 2008.

How Are Charities Funded?

Revenue

Charities raise revenue from a variety of sources. The first source of revenue is from fees or private payments for service. The second way charities raise money is through the receipt of government grants and payments. Charities also rely on funding via private contributions (from individuals, corporations, bequests, and foundations). Finally, charities are able to raise revenue by earning returns on investments as well as through some other revenue sources. **Figure 4**

illustrates how much total revenue was raised in 2005 from each of these revenue sources. Overall, charitable organizations raised \$1.2 trillion in revenue in 2005.

Private payments for service are the largest category of revenue for charitable organizations. Private payments for service may include a wide variety of services, such as payments for medical care and education tuition. In 2005, charities collected \$590 billion in payments for services. Payments for services constituted 49% of total revenue in 2005.

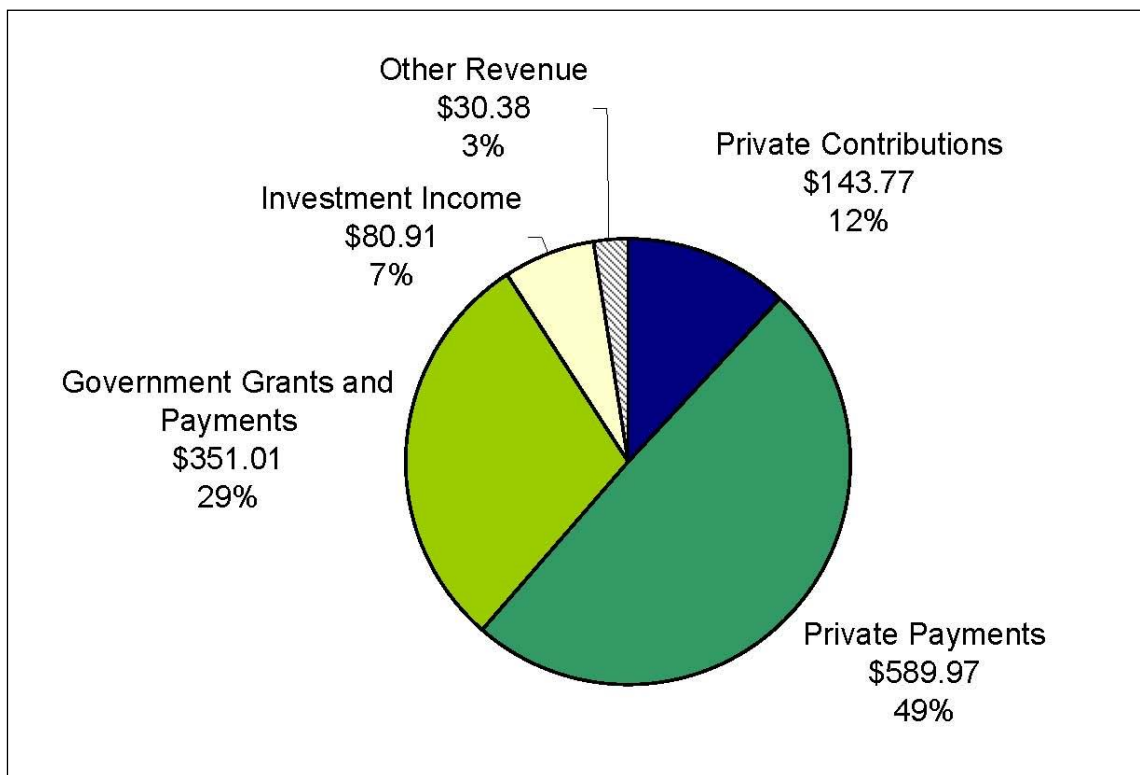
Government grants and payments represent the second largest revenue source for charitable organizations. In 2005, \$351 billion worth of government grants and payments were made to charities, or 29% of total revenue. While it appears from this measure that the government plays only a moderate role in financing charitable organizations, it is important to remember that the government subsidizes the activities of charitable organizations in other ways. For example, charities receive various tax benefits, such as exemption from federal income tax, eligibility to receive tax-deductible donations, and the ability to issue tax exempt bonds,¹⁵ in addition to indirect benefits that may arise from undertaking activities encouraged by other incentives in the tax code.¹⁶ This report provides further detail on the government's relationship with the nonprofit and charitable sector below.

¹⁵ Large nonprofit institutions, such as hospitals and educational institutions, have long used tax-exempt bonds to finance capital improvements. Recently, more smaller nonprofit organizations have taken advantage of the ability to issue tax-exempt debt to finance capital costs. For examples, see Steven Rathgeb Smith, "Government Financing of Nonprofit Activity," in *Nonprofits & Government*, ed. Elizabeth T. Boris and C. Eugene Steuerle, 2nd ed. (Washington, DC: Urban Institute Press, 2006), pp. 219-256.

¹⁶ There are indirect relationships between other elements of the tax code and the provision of goods and services by charitable organizations. It has been argued that both the child and dependent care credit and the Low-Income Housing Tax Credit (LIHTC) make services provided by nonprofit organizations more profitable, therefore increasing the demand for such services. See Steven Rathgeb Smith, "Government Financing of Nonprofit Activity," in *Nonprofits & Government*, ed. Elizabeth T. Boris and C. Eugene Steuerle, 2nd ed. (Washington, DC: Urban Institute Press, 2006), pp. 219-256.

Figure 4. Revenue by Source, 2005

(billions of dollars)



Source: Wing, Pollak, and Blackwood, *The Nonprofit Almanac*, 2008, p. 134 and CRS calculations.

Notes: CRS calculations based on data provided by the National Center on Charitable Statistics based on data from the Internal Revenue Service, Statistics of Income Division Exempt Organizations Sample Files, public charities only. This sample is derived from organizations filing Form 990 and thus does not include small organizations or religious charities.

Private contributions in 2005 were \$143.77 billion, or 12% of overall revenue to charitable organizations. There is substantial attention given to this revenue source, as it is believed that private contributions to charities are likely to fluctuate in response to changes in economic conditions and the tax treatment of contributions. These issues are explored in greater detail below.

Charitable organizations made \$81 billion from investments in 2005, which represents 7% of their overall revenue. Investment income includes the sales of securities, interest, and dividends. The recent recession has likely decreased revenue flowing into charitable organizations from investment income. For example, university endowments lost 23% on average between July 1, 2008, and November 30, 2008.¹⁷

Other revenue, of which there were \$30 billion in 2005, make up 3% of overall revenue received by charitable organizations. These revenue come from revenue sources such as membership dues, net special events income, and other miscellaneous revenue-raising activities.

¹⁷ John Hechinger, "College Endowments Plunge," *The Wall Street Journal*, January 27, 2009, p. D3.

Revenue Sources by Charitable Sector

Charitable organizations are highly heterogeneous. One aspect of heterogeneity is charitable organizations' revenue sources. To explore this further, **Figure 5** examines the distribution of revenue sources across different types of charities. The data used to derive **Figure 5** is available in **Table A-1**. While the reliance of different types of charities on various revenue sources varies along a number of dimensions, there are a few patterns of particular interest.

First, it is clear from the chart that charities providing education and health care receive the majority of their revenue from private payments for service. These fee-for-service organizations are much less reliant on private contributions than other types of charities. It is also important to note that for hospitals, the government grants and payments category includes government payments via Medicare and Medicaid.

The charts in **Figure 5** also show that arts, culture, and humanities and environment and animals charities rely most heavily on private contributions.¹⁸ Charities that rely heavily on private contributions are more susceptible to economic fluctuations and changes in the tax code that would affect individual giving. These issues are discussed further below.

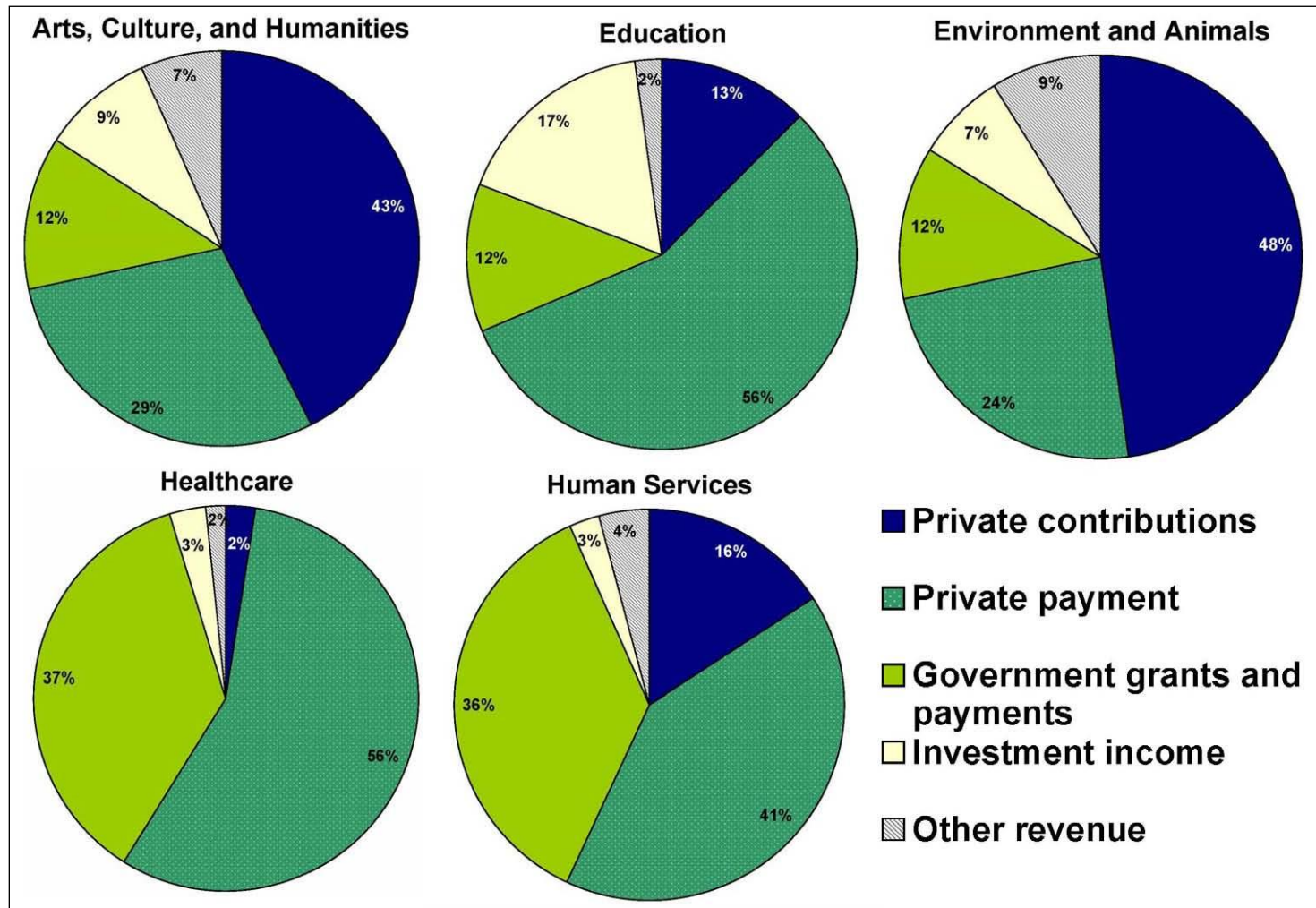
The charitable sector that is most reliant on investment income is education. Nearly 17% of the charitable education sector's revenue in 2005 were generated from investments. For higher education institutions, this figure was over 19%. As noted above, university endowments suffered substantial losses in 2008. Revenue for educational institutions are more susceptible to fluctuations in markets likely to impact investment income than other types of charitable organizations.

Overall, understanding what types of charitable organizations have a greater reliance on specific sources of revenue may help policymakers understand the potential for external economic conditions to impact the well-being of the charitable sector. Educational institutions, with a greater reliance in investment income, are more likely to be adversely affected directly by the downturn of financial markets.¹⁹ Charities where a larger proportion of revenue come from private contributions, such as arts, culture, and humanities and environment and animals, are more likely to be impacted by changes apt to cause fluctuations in private giving, such as changes to the tax code. Charities that derive the majority of their revenue from private payments, such as health care and education institutions, are less likely to suffer revenue losses when external factors cause changes to the level of private giving.

¹⁸ Charities classified as international receive the vast majority, 72%, of their funds from private contributions.

¹⁹ Private donations may also be expected to decline when financial markets falter as potential donors' loss of wealth corresponds to reduced giving.

Figure 5. Comparing Revenue Sources Across Charitable Sectors
(2005 share of total revenue)



Source: CRS calculations using data published by Wing, Pollak, and Blackwood, *The Nonprofit Almanac*, 2008, p. 134.

Notes: Data is from the National Center on Charitable Statistics based on U.S. Internal Revenue Service, Statistics of Income Division, Exempt Organizations Sample Files, public charities only.

Growth in Revenue Sources

Table 9 shows the percentage change in real revenue between 1995 and 2005 delineated by charitable sector. Total revenue received by charitable institutions grew by 68.6% over this time period. Private payments to charitable organizations grew more during the time period than other revenue sources. Much of this increase appears to be driven by the increase in private payments received by hospitals.

The portion of the charitable sector involved in health care receives the majority of their revenue from private payments. Private payments in the health care sector have also grown faster than private payments in any other sector. As the revenue demands for health care charities generally have increased, these charities have seen a greater increase in private payments than in other revenue sources. In fact, between 1995 and 2005, the portion of revenue from private payments declined in real terms for charitable health care organizations (although this figure still increased for hospitals).

Some charitable sectors have experienced much larger growth in revenue with respect to private contributions than others. Overall, private contributions to charitable sectors increased nearly 69% between 1995 and 2005. However, charities involved with the environment and animals, human services, and international issues all experienced growth in revenue from private contributions in excess of 100% during that time period.

It is also noteworthy that growth in investment income between 1995 and 2005 was highest for charities in the education sector. Education receives a larger proportion of their revenue from investment income than most other charitable sectors. This trend is driven by higher education institutions, where the growth in the share of revenue coming from investment income has been the highest in the time period observed. Again, it should be noted that the financial assets of higher education institutions did not fare well in 2008, and the growth in the revenue coming from investment income has likely slowed.

Finally, the charitable sectors that have seen the largest growth in revenue overall are relatively small. Between 1995 and 2005 the revenue flowing into the international charitable sector increased by 190%. The international sector, however, still earned less than 1.7% of the charitable sector's total revenue. The environmental charitable sector's revenue also increased more than average, 90% between 1995 and 2005. Even in the face of this rapid growth, the environmental charitable sector captures less than 1% of charitable organizations' total revenue.

Table 9. Percentage Change in Real Revenue, 1995 - 2005

	Private Contributions	Private Payments	Government Grants and Payments	Investment Income	Other Revenue	Total
Arts, culture, and humanities	91.36	53.40	59.51	28.86	53.85	65.32
Education	59.07	62.01	70.50	76.10	44.36	64.40
Higher education	41.75	60.54	62.93	89.00	52.88	63.00
Other education	116.15	68.58	95.50	10.47	25.00	70.20
Environment and animals	136.73	78.29	114.55	51.06	3.66	90.18
Health care	-19.26	105.85	48.43	60.37	66.62	72.83
Hospitals	88.86	112.42	43.60	55.54	102.06	76.48
Other health services	-46.15	89.17	80.47	76.03	-2.24	61.54
Human services	102.33	88.85	41.97	25.27	57.99	67.03
International	302.45	83.93	71.70	66.67	-28.57	190.62
Other operating public charities	44.39	81.37	166.37	-21.23	7.84	65.89
Supporting public charities	96.77	-20.76	100.46	66.93	13.98	41.32
Total	68.89	83.27	52.73	56.93	44.82	68.60

Source: CRS calculations based on data from Wing, Pollak, and Blackwood, *The Nonprofit Almanac, 2008*, p. 134-137.

Notes: Revenue are adjusted to constant dollars prior to calculating the percentage change. The percentage change is the change in revenue over the 1995 to 2005 time period.

Nongovernmental Financing: Private Contributions

Private contributions to charitable organizations come from four different sources. The first is gifts from individuals. In 2008, individuals gave \$229.28 billion.²⁰ The second is charitable bequests, or gifts from estates. In 2008, total bequests were valued at \$22.66 billion.²¹ The third source of giving comes from corporations. Corporations gave \$14.50 billion in 2008.²² Finally, grants to charitable organizations are made by foundations. In 2008, it is estimated that foundations gave \$41.21 billion. Total giving by all four groups was \$307.65 billion in 2008.

Total giving in 2008 was 2% less (5.7% less after adjusting for inflation) than total giving in 2007. This is the first decline in giving since 1987. **Figure 6** shows giving by individuals, bequests, corporations, and foundations in real terms in 1998, 2007, and 2008. Between 2007 and 2008, giving by individuals and from bequests both fell by more than 6% (in real terms). Giving by corporations fell by 8% (in real terms). Giving from foundations remained relatively constant, falling by less than 1% (in real terms). Despite the recent reduction in the amount of contributions

²⁰ The Center on Philanthropy at Indiana University, *Giving USA 2009* (Indianapolis, IN: Giving USA Foundation, 2009), p. 210. This figure includes estimated charitable deductions on 2008 tax returns as well as an estimate of charitable giving by those who do not itemize deductions on taxes. This figure exceeds that reported above for private contributions because it includes giving to small organizations and churches, of which neither are required to file Form 990.

²¹ Charitable bequests include both those reported on 2008 estate tax returns and those given by estates not subject to the estate tax.

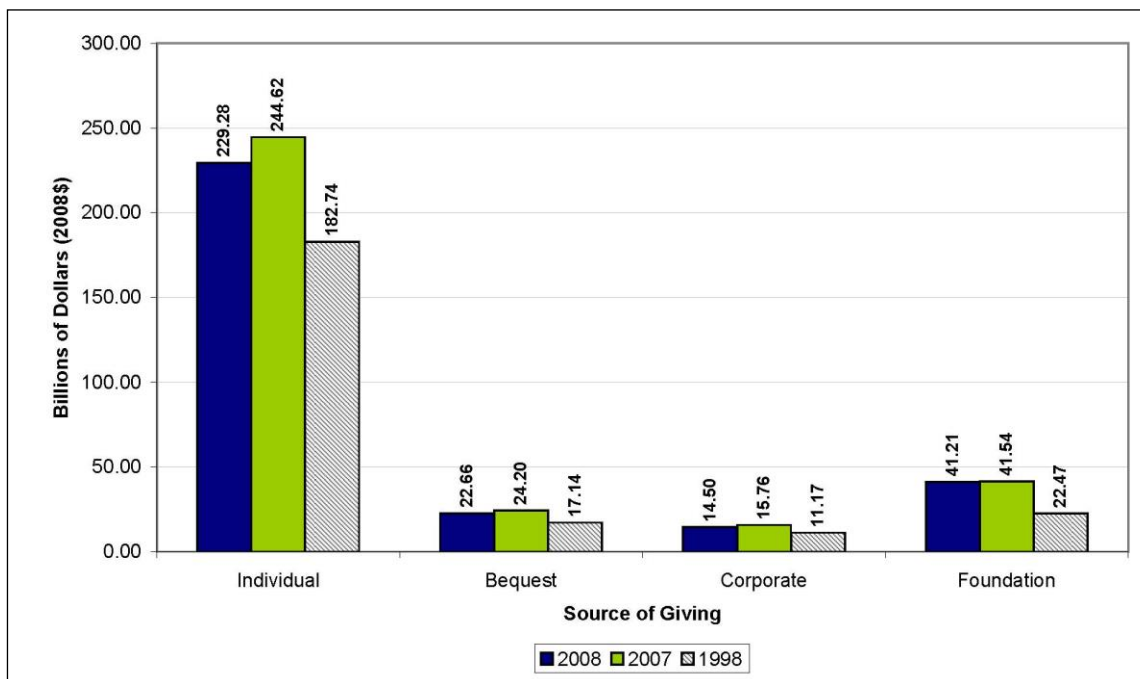
²² Corporate giving, as calculated by The Center on Philanthropy at Indiana University, *Giving USA 2009*, includes grants made by corporate foundations to charities but does not count giving by corporations to foundations.

charities receive from gifts, charitable organizations still received more in 2008 than they did a decade earlier. In real terms, gifts from individuals increased by 25% between 1998 and 2008, bequests increased 32%, corporate giving increased 30%, and gifts from foundations increased by 83%. While real giving has increased, looking at giving relative to the size of the overall economy provides a better picture of society's generosity.

To evaluate the generosity of society over time the ratio of charitable giving to GDP is examined. **Figure 7** plots giving as a percentage of GDP and disaggregates giving across sources. Giving as a percentage of GDP was greater than 2% into the 1970s. From the early 1970s through the late 1990s giving as a percentage of GDP remained below 2%. In the late 1990s, giving as a percentage of GDP began to increase, reaching a peak of 2.37% of GDP in 2005. Since 2005, giving as a percentage of GDP has fallen. In 2008, giving as a percentage of GDP was 2.16%.

The increase in giving as a percentage of GDP between the 1990s and 2000s was driven primarily by giving from individuals and giving from foundations. Prior to the late 1990s, giving by individuals was less than 1.5% of GDP. Since 1999, giving as a percentage of GDP by individuals has not fallen below 1.6%. In 2008, giving as a percentage of GDP by individuals was 1.61%, down from its peak of 1.78% in 2005. Throughout the 1980s and most of the 1990s giving by foundations never exceeded 0.15% of GDP. In 2008, this ratio was 0.29%. Giving as a percentage of GDP by foundations increased between 2007 and 2008. Overall, giving as a percentage of GDP by foundations has nearly tripled since the 1970s.

Figure 6. Charitable Giving



Source: CRS calculations based on data from The Center on Philanthropy at Indiana University, *Giving USA 2009*, pp. 210-211.

Notes: Giving by individuals, bequests, corporations, and foundations is presented in 2008 dollars. Real values were calculated using the CPI-U.

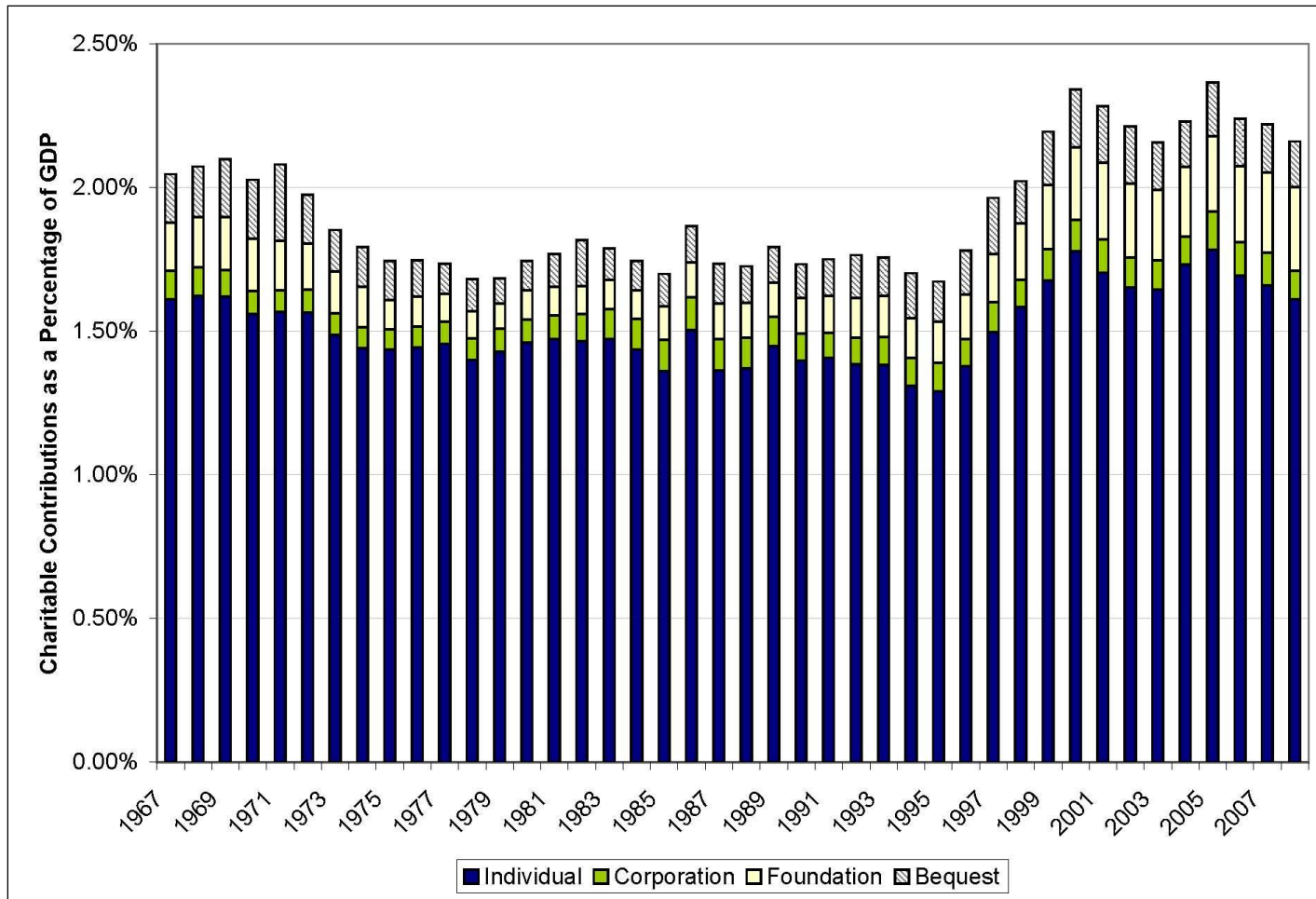
Giving relative to GDP by bequests and corporations does not exhibit such clear patterns. Corporate giving as a percentage of GDP in 2008 was 0.10%. Relative to GDP, corporate giving

in 2008 was the same as it was throughout most of the 1990s. Corporate giving relative to GDP was lower (0.07% - 0.08%) in the 1970s and higher (0.12% - 0.13%) in 2005 and 2006. Bequests relative to GDP were 0.16% in 2008, lower than they were in the early 2000s (when the ratio was 0.20%). Compared to the 1970s and 1980s, bequests as a percentage of GDP are still 0.03 – 0.06 percentage points higher.

To more fully understand the impact of giving on the charitable sector, it is important to address what types of charities receive gifts. **Figure 5** illustrates that the largest source of funding for arts, culture, and humanities as well as for environment and animals charities is private donations. Both of these types of charitable organizations received more than 40% of their revenue from private donations in 2005.²³

²³ The data presented in the revenues section is for charitable organizations filing Form 990. Therefore, these data do not include small organizations or churches. The data in this section are for all charitable gifts and do include donations given to charitable religious organizations.

Figure 7. Giving as a Percentage of GDP, 1967-2008



Source: CRS calculations based on data from The Center on Philanthropy at Indiana University, *Giving USA 2009*, pp. 210-211.

Figure 8 plots giving to different types of charitable organizations in 2008, 2007, and 1998. When looking at data from the giving perspective, it is clear that religious organizations are the recipients of the largest share of gifts. Further, religious organizations were one of the few categories to experience an increase in giving between 2007 and 2008. Overall, giving fell by 5.7% between 2007 and 2008, with the largest declines in gifts to grantmaking foundations (-22%); human services (-16%); and arts, culture, and humanities (-9%).

Between 1998 and 2008 overall giving increased by nearly 32% in real terms. Again, there was wide variation across sectors. The sectors that experienced the largest increases in giving over the course of the decade were international affairs (98%), environment and animals (42%), and education (30%).²⁴ Giving to religion grew over the course of the decade, but the rate of growth was relatively low (19%). Giving to arts, culture, and humanities decreased by 2% between 1998 and 2008. This is particularly noteworthy since the arts, culture, and humanities charitable sector receives the largest share of revenue from private contributions.

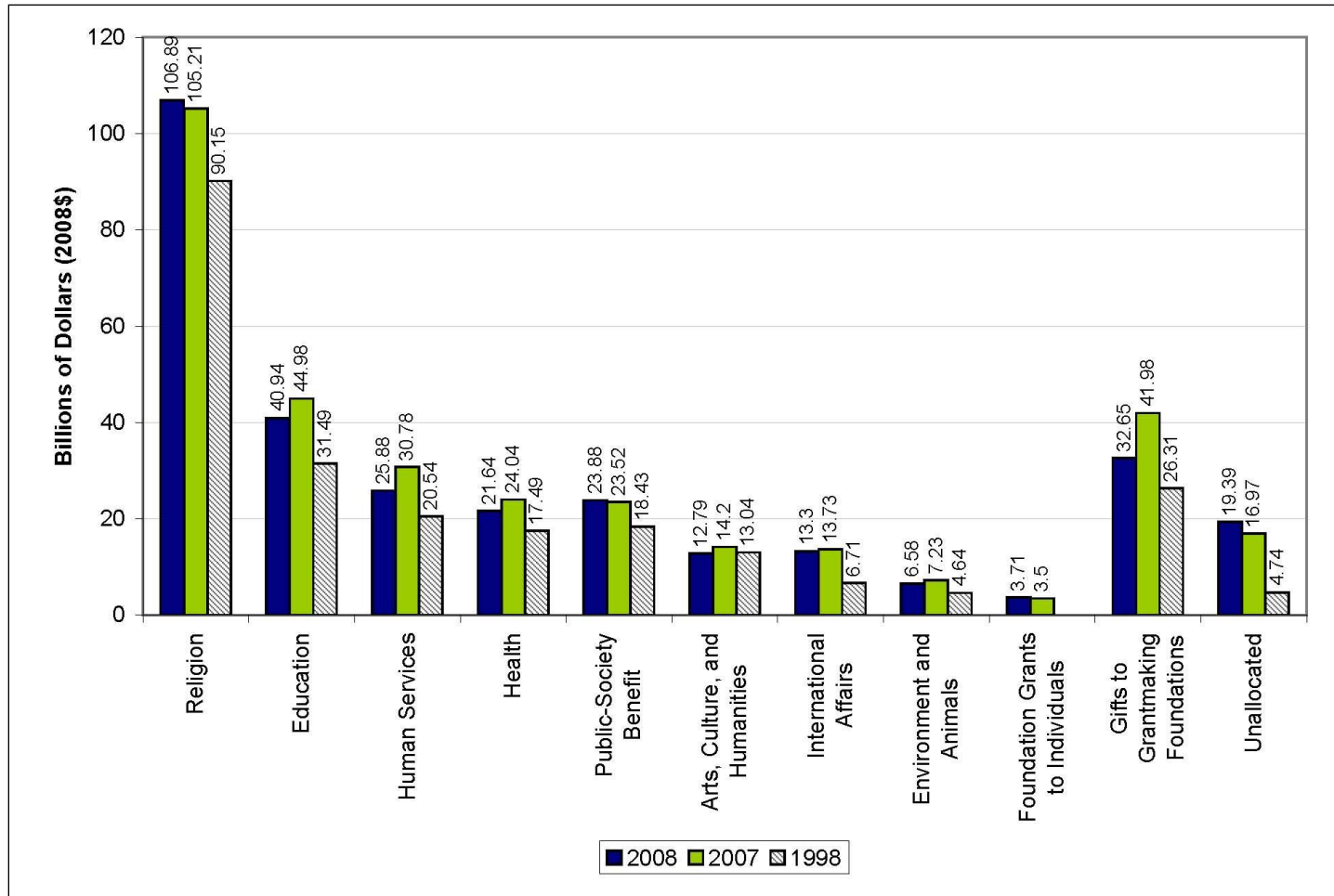
There are a number of issues which may affect giving by individuals. These include whether or not individuals can deduct contributions, fluctuations in personal income, and broader economic conditions. Individuals who itemize deductions have a greater incentive to give, as the price of giving is reduced by the marginal tax rate. In 2005, those itemizing gave on average 3.54% of their adjusted gross income. Non itemizers gave on average 1.34% of their adjusted gross income.²⁵ It is important to note, however, that those choosing to itemize deductions tend to have higher incomes and thus perhaps a greater ability to give. Individual charitable deductions are subject to various restrictions, which include being generally limited to 50% of modified adjusted gross income.²⁶

²⁴ Unallocated giving actually had the largest increase, tripling in value over the decade.

²⁵ Wing, Pollak, and Blackwood, *The Nonprofit Almanac*, 2008, p. 92.

²⁶ Individual gifts to certain types of nonprofits and gifts of specific types of assets may be further restricted.

Figure 8. Giving to Charities by Type



Source: CRS calculations using data from The Center on Philanthropy at Indiana University, *Giving USA 2009*, pp. 212-215. All values are adjusted to 2008 dollars using the CPI-U.

Individual giving to charity is also responsive to income. **Table 10** shows how giving and the amounts given vary across three different income groups. In 2004, 56.3% of households with less than \$50,000 in income gave to charity, 81.4% of households with income between \$50,000 and \$99,999 gave to charity, and 93.3% of households with income greater than \$100,000 gave to charity.²⁷ In 2004, the average household gave just over \$2,000. This figure appears to be driven by a few households making relatively large gifts as the median charitable gift was \$775. The average giving for households making \$100,000 or more per year was more than three times the average giving of households making less than \$50,000. The median gift by households making more than \$100,000 was more than four times as much as the median level of giving by households making less than \$50,000 per year.

Table 10. Giving and Household Income, 2004

	All Income Groups	< \$50,000	\$50,000 - \$99,999	\$100,000 and above
% of households giving	70.2%	56.3%	81.4%	93.3%
Average annual amount per donor household	\$2,047	\$1,186	\$1,871	\$3,886
Median annual amount per donor household	\$775	\$450	\$815	\$1,830

Source: Center on Philanthropy Panel Study, 2005 Wave.

Economists have also made attempts to measure the elasticity of charitable giving with respect to income, which is the percentage change in giving relative to the percentage change in income. Empirical work that has attempted to estimate the elasticity of charitable giving with respect to income has produced a wide range of results.²⁸ While many studies have found an income elasticity of less than one, the fact that individual contributions relative to GDP have remained relatively constant over time (see **Figure 7**) suggests that income elasticity is more likely unit elastic. If the income elasticity were in fact less than one, as income increased over time one would expect charitable giving relative to income to decline.²⁹

Charitable bequests are given by estates upon an individuals' death. It is estimated that about 120,000 estates leave bequests each year. Most bequests come from small to mid-sized estates, where the estate is small enough in size that filing of estate tax returns is unnecessary. Only about 8,000 estates filed estate tax returns in 2008. These 8,000 estates were responsible for about 85% of all giving via bequests, illustrating that giving via bequests is highly concentrated amongst the most wealthy decedents.³⁰ Concern is often expressed that a reduction in or elimination of the

²⁷ The Center on Philanthropy Panel Study does not include data from very-high-income households.

²⁸ William Randolph, "Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions," *The Journal of Political Economy*, vol. 103 (August 1995), pp. 703-738; Gerald E. Auten, Holger Sieg, and Charles T. Clotfelter, "Charitable Giving, Income, and Taxes: An Analysis of Panel Data," *The American Economic Review*, vol. 92, no. 1 (March 2009), pp. 371-382; and Jon Bakija and Bradley Heim, *How Does Charitable Giving Respond to Incentives and Income? Dynamic Panel Estimates Accounting for Predictable Changes in Taxation*, National Bureau of Economic Research, Working Paper 14237, Cambridge, MA, August 2008.

²⁹ For further discussion see CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples.

³⁰ The Center on Philanthropy at Indiana University, *Giving USA 2009*, p. 53.

estate tax would lead to reduced giving to the charitable sector.³¹ Recent work has found that bequests are responsive to changes in estate taxes as well as overall wealth.³²

Corporate giving can be made in one of two ways. The first way is as a direct gift from the corporation. The second way is via a corporate foundation. A typical corporation is estimated to give about 1% of its domestic pre-tax income to charitable organizations, or about 0.08% of corporate sales.³³ Corporations' charitable deductions are generally limited to 10% of taxable income, among other restrictions.

The final source of private contributions or charitable gifts comes from foundations. As noted above, in relative terms, giving by foundations has increased more than giving by individuals, bequests, and corporations over the past decade. In 2008, The Bill and Melinda Gates Foundation gave \$2.8 billion in grants (giving by all foundations was \$41.2 billion in 2008). Giving by the Gates Foundation increased by \$0.8 billion between 2007 and 2008, contributing to the overall stability of foundation giving between 2007 and 2008 as grantmaking by other foundations fell.

Government Financing: Grants and Transfers

From **Figure 4**, government grants and payments to charitable organizations were \$351 billion, or 29% of charitable organizations' total revenue. What **Figure 4** does not do is identify whether payments were made for fees for service (such as Medicare payments), grants, or transfers. Similarly, **Figure 5** shows that the share of government grants and payments in total revenue varies substantially across different types of charities. Government grants and payments are much more important in health (37%) and human services (36%) than in other types of charitable organizations.

Table 11 reports estimates of the share of revenue that comes from grants alone, excluding fees for services. These data are gathered directly from the Form 990 for charitable organizations that were required to report. The data used to generate **Figure 4** and **Figure 5** were from the IRS Statistics of Income division exempt organization sample files on public charities. In a few cases grants are larger as a share of income than the share of total payments reported above. These grants, of course, may have performance requirements, but they are not allocated to particular individuals and services received.

Table 11. Share of Revenue from Government Grants, 2005

Type of Nonprofit	Share From Government Grants (%)
Arts, culture, and humanities	12.5
Education	14.9
Environment and animals	14.1
Health	3.4
Human services	22.7

³¹ For estimates of how changes in the estate tax would impact charitable giving see CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples.

³² Jon M. Bakija, William G. Gale, and Joel B. Slemrod, "Charitable Bequests and Taxes on Inheritances and Estates: Aggregate Evidence from across the States," *American Economic Review*, vol. 93, no. 2 (May 2003), pp. 366-370.

³³ Sophia A. Muirhead, *The 2006 Corporate Contributions Report*, Conference Board, Report R-1399-06-RR, New York, NY, 2007.

Type of Nonprofit	Share From Government Grants (%)
International and foreign	21.9
Other	18.9
Total	9.0

Source: CRS calculations using data from Wing, Pollak, and Blackwood, *The Nonprofit Almanac*, 2008, p. 134.

Government grants are about 9% total revenue for the charitable sectors included in **Table A-1**, or about \$100 billion for 2005. The data indicate that government payments for health as a share of revenue are primarily due to fees. Virtually all of the government payments in the remaining sectors, other than human services, reflect grants.³⁴ Grants are most important in human services and international organizations, and least important in health. These data do not include religious organizations, where government grants are unlikely to be an important source of revenue. Grants reflect the nature of the specific charities (they are less important for organizations such as hospitals that rely heavily on fees). Grant support is more important in areas where the government has a special interest, such as the human services and international sectors.

The Bureau of Economic Analysis's (BEA's) National Income and Product Accounts provides information on government transfers, which are relatively small. In 2007, the government provided approximately \$20 billion in transfer payments for all nonprofit organizations serving households.³⁵ It is not clear how transfers are defined, but grants can include contracts and agreements for services, as well as transfers. The BEA data does not separate these transfers by type of charitable organization.

The data presented here do not separate state and local government funding from federal government funding. Government funding to charitable organizations may come directly from the federal government, from state and local governments that have received the funding from the federal government (rather than raised the revenue themselves), or directly from state and local governments. One study finds that, for 2001, only 12% of grants and fees originate with state and local governments; 37% are financed by the federal government but flow through to nonprofits via state and local programs, and the remaining 51% are provided directly by the federal government.³⁶ If Medicare and Medicaid, the main fee-related items, are excluded, the states continue to supply only a small share (9% of their own funds) but administer a much larger share of federal funds (61%). While the federal government appears to be the primary source of funds via grants, state and local governments are the primary source of oversight.

The Business Cycle's Impact on Funding

As is the case for many entities during an economic downturn, charities may suffer declines in funding. For some, the decline comes at the time when their services may be in greater demand. Analysis of past recessions suggests that the level of charitable giving declines during downturns, but that charitable giving as a percentage of income does not decline. The level of giving has

³⁴ **Figure 5** does not report international, which is a very small charitable sector. In the international sector government grants and payments were 20% of revenues, which, comparing with the shares in **Table A-1** indicates that all government support to the international sector came in the form of grants.

³⁵ See http://www.bea.gov/scb/pdf/2008/11%20November/1108_newnipas.pdf.

³⁶ Woods Bowman and Marion R. Fremont Smith, "Notes on Nonprofits and State and Local Governments" In *Nonprofits and Government, Collaboration and Conflict*, ed. by Elizabeth T. Boris and C. Eugene Steuerle, Washington, D.C., Urban Institute 2006, pp. 181-218.

declined during the current recession. Nonprofits overall tend to fare no worse than, and perhaps better than, other sectors during downturns, although this recession may have been more troubling because of the fall in asset values.

There are significant differences in giving trends across different types of charitable organizations. The greatest decline in giving during the recent economic downturn has been for human welfare organizations. Human welfare organizations as a sector are likely to experience increased needs for their services during a downturn. While giving declined in inflation-adjusted terms between 2007 and 2008 by 6%, the decline for human services organizations was 16%.³⁷

Recessions can also affect assets, such as those held by university endowments and foundations (whose purpose is primarily to provide grants to active charitable organizations). The current recession has been accompanied by a significant fall in the value of assets which affected charitable organizations' assets. Despite the fall in asset values and in gifts to foundations, foundation grants to other organizations fell less than inter-vivos giving by individuals, bequests, and corporate giving.

Another major pressure on nonprofits during the recession has been the decline in support by governments (primarily state governments), including delays in payments. A recent survey of nonprofit organizations found that 35% have experienced a loss in government support while 37% reported experiencing delays in government payments.³⁸

How Have Nonprofits Fared During Past Economic Downturns?

Sectors of the economy fare differently during a recession. Generally, sectors that produce investment and durable consumer goods (such as housing, automobiles, and household furnishings) and luxuries tend to suffer the largest declines in demand. Necessities and items that are immediately consumed, such as food and health care, tend to be more resistant, as are items that are a small part of the household budget. That is, individuals tend to economize on big-ticket items whose purchase they can delay.

Charitable contributions tend to share features of both types of goods. While charitable contributions are not a necessity, they are typically small as a part of individuals' budgets. Evidence indicates that there is a tendency for giving to fall in real (inflation adjusted) terms during a recession. During the 12 recession years since 1967, charitable giving declined in 8 of those years.³⁹

Charitable Contributions in Past Recessions

Although real giving tends to decline during recessions, it is not clear that giving is affected more than average expenditures. **Figure 9** shows the pattern of giving as a percentage of GDP from 1967 through 2008. Recession years are noted via shaded bars.⁴⁰ Charitable giving as a

³⁷ The Center on Philanthropy at Indiana University, *Giving USA 2009*, p. 119.

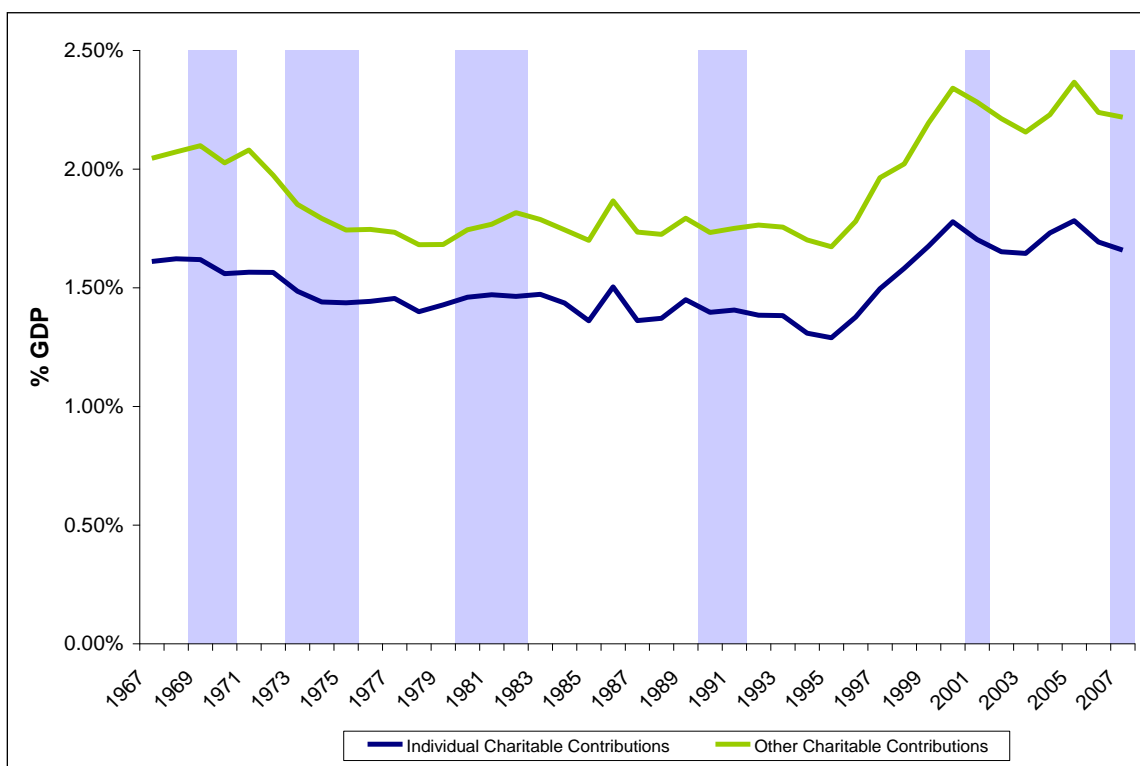
³⁸ Lester M. Salamon, Stephanie L. Geller, and Kasey L. Spence, *Impact of the 2007-2009 Economic Recession on Nonprofit Organizations*, Johns Hopkins University Center for Civil Society Studies, Communique No. 14, 2009, http://www.ccss.jhu.edu/pdfs/LP_Communique/LP_Communique_14.pdf.

³⁹ USA Today, *Giving by the Numbers*, April 24, 2009, http://www.usatoday.com/news/sharing/2009-04-13-numbers_N.htm?loc=interstitialskip

⁴⁰ The small dip and peak around 1986 is generally attributed by most researchers to a temporary rise in deductions reflecting a timing shift as tax cuts for 1987 and 1988 were pre-announced in the 1986 tax cut. By 1989 contributions had returned to their previous levels.

percentage of GDP has remained relatively stable over business cycles. Overall, there has been an upward trend in giving as a share of output since the 1980s.

Figure 9. Charitable Contributions as a Percentage of Output, 1967-2007



Source: CRS calculations based on the Center for Philanthropy, *Giving USA 2009*, and National Income and Product Accounts. Other charitable contributions (the difference between the two lines) include corporate, foundations, and bequests. A version of this chart appeared in CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples.

The Current Recession: Charitable Giving in 2008

Charitable giving declined during the recent recession, with a fall of 2% in nominal terms from 2007 to 2008.⁴¹ This reduction was a decline of 5.7% adjusted for inflation. The declines differed depending on both the source of giving and the recipient as shown in **Table 12**. The pattern for foundation grants suggests that, despite the loss in value that occurred in assets in this period, using assets to finance grants seemed to provide more stability in giving. There is evidence that giving by foundations has acted as a stabilizing force in the past.⁴²

⁴¹ The data on patterns of giving between 2007 and 2008 are from The Center on Philanthropy at Indiana University, *Giving USA 2009*, p. 210. A summary of the findings can be found at http://www.philanthropy.iupui.edu/News/2009/docs/GivingReaches300billion_06102009.pdf. Information on the effects by sector are also summarized at <http://blog.charitynavigator.org/2009/06/giving-in-2008.html>.

⁴² Steven Lawrence, *Do Foundation Giving Priorities Change in Times of Economic Stress?* Foundation Center, http://foundationcenter.org/gainknowledge/research/pdf/researchadvisory_economy_200811.pdf.

Table 12. Changes in Giving by Source, 2007-2008

Source of Giving	Share of Giving (%)	Nominal Change (%), 2007-2008	Inflation Adjusted Change (%), 2007-2008
Individual	75.0	-2.7	-6.3
Bequest	7.0	-2.8	-6.4
Foundation	13.0	3.0	-0.8
Corporate	5.0	-4.5	-8.0
Total	100.0	-2.0	-5.7

Source: CRS calculations using data from The Center on Philanthropy at Indiana University, *Giving USA 2009*, pp. 210-211.

The effects also differed by the recipient of giving. As shown in **Table 13**, different types of charities are affected in different ways. Religious giving, which accounts for the largest share of the total, had an increase in real giving between 2007 and 2008 of 1.6%, a differential of 7.3 percentage points from the average effect. The other sector with an increase, public society benefit organizations, include organized giving arrangements that flow through to other beneficiaries, such as United Way, Jewish funds, and donor-advised funds. The largest decline in giving was for foundations, but these institutions largely accumulate assets and make grants to other organizations, and their giving to other organizations was more stable than other giving. Outside of foundations, the organization that had the greatest drop in inflation-adjusted contributions, 16%, was for human services, where the needs during a downturn and dependence on contributions are likely the greatest. Most other institutions had a real decline of 9% to 10% (education, health, arts, environment), 4 percentage points worse than the average across all institutions. International affairs had a smaller drop than average, 3.6%.

Table 13. Changes in Giving by Recipient, 2007-2008

Charitable Recipient Sector	Share of Giving (%)	Nominal Change (%), 2007-2008	Inflation Adjusted Change (%), 2007-2008
Religious	35.0	5.5	1.6
Educational	13.0	-5.5	-9.0
Foundations	11.0	-19.2	-22.2
Human services	9.0	-12.7	-15.9
Health	7.0	-6.5	-10.0
Public society benefit	8.0	5.4	1.5
Arts, culture, humanities	4.0	-6.4	-9.6
International affairs	4.0	0.6	-3.6
Environment/animals	2.0	-5.5	-9.0

Source: The Center on Philanthropy at Indiana University, *Giving USA 2009*, pp. 212-215. Unallocated giving accounts for 6% of giving.

It is important to note that nonprofit organizations that receive charitable contributions generally have other important sources of revenue, such as user fees, earnings from assets, or government

support. **Figure 4** shows that total charitable contributions received as a share of total revenue of public charities was approximately 12% in 2005. For the health care sector, which includes nonprofit hospitals, charitable contributions were approximately 2% of total revenue in 2005 (see **Figure 5**). The share of charitable contributions in total revenue varies for other sectors. In 2005, arts, culture, and humanities organizations received approximately 43% of their revenue from charitable contributions, the education sector about 13%, environment and animals 48%, and human services 16%.

Some of these nonprofit institutions may be fairly resilient to cyclical pressures (such as hospitals). Attendance at colleges and universities is also likely to rise when jobs are scarce. Charitable organizations and giving are also linked to endowments which can be a source of funds in difficult times (but may also fall in value during a recession).

Endowments and Assets

The National Association of College and University Business Officers (NACUBO) follows the endowment size of colleges and universities, covering their fiscal years which normally begin on July 1. For the 2008 fiscal year (covering the second half of 2007 and the first half of 2008) asset values rose by 0.5%, a loss in real terms and much smaller than previous growth. A special follow-up survey found a 22.9% decline in the five months from July 1, 2008, to November 30, 2008.⁴³ (Corporate stocks fell further, but have since begun to recover.) Foundations experienced a 28% drop in the value of assets during 2008.⁴⁴

Foundations hold a large quantity of financial assets. In 2007, total foundation assets were estimated to be \$682 billion.⁴⁵ Community foundation assets represent a relatively small share of that total, \$56 billion in 2007.⁴⁶ The largest foundation, the Bill and Melinda Gates Foundation, had assets of \$39 billion, while the top 10 foundations by asset size held \$112 billion in 2007.⁴⁷

Data on returns filed with the Internal Revenue Service on public charities showed assets held by charities in 2006 to be \$2.2 trillion, but a large share of this figure is likely to be buildings and other physical assets. (This amount does not include most assets of religious organizations.) Charitable organizations related to health (likely to be hospitals) accounted for \$867 billion. Education accounted for \$682 billion. Educational institutions are known to have large endowments, and endowments accounted for half their assets.⁴⁸ University endowments had been growing rapidly, and in the latest reports, total assets rose to \$837 billion (the total for all public charities was \$2.6 trillion, and for hospitals \$921 billion).⁴⁹ Earnings from endowments appear, overall, to be larger than receipts from charitable contributions for colleges and universities, although endowments are highly concentrated in large institutions.⁵⁰

⁴³ NACUBO and Commonwealth Institute Survey, <http://www.nacubo.org/documents/research/NES2008Follow-upSurveyReport.pdf>.

⁴⁴ *Asset Declines and Investment Strategy: Change by Family, Independent, and Public Foundations*, Council on Foundations, <http://www.cof.org/files/Documents/Conferences/09FamPhilConf/EconSurvey4.pdf>.

⁴⁵ See http://foundationcenter.org/findfunders/statistics/pdf/02_found_growth/2007/04_07.pdf.

⁴⁶ See http://foundationcenter.org/findfunders/statistics/pdf/02_found_growth/2007/00_07.pdf.

⁴⁷ See <http://foundationcenter.org/findfunders/topfunders/top100assets.html>.

⁴⁸ Based on total endowments reported in Jane G. Gravelle, testimony before the Senate Finance Committee, September 26, 2007; the sum of endowments reported by NACUBO, <http://finance.senate.gov/hearings/testimony/2007test/092607testjg.pdf>.

⁴⁹ See <http://nccsdataweb.urban.org/NCCS/V1Pub/index.php/>.

⁵⁰ Jane G. Gravelle, testimony before the Senate Finance Committee, September 26, 2007; the sum of endowments

Another consequence of loss of asset value is likely reduced individual giving, especially by high-income donors and through bequests. High-income donors tend to be more likely than the average donor to contribute to certain types of nonprofits, such as health, education, and arts, as well as foundations, and less likely to contribute to religious and human welfare organizations.⁵¹ As asset values fall, reducing the wealth of high-income donors, charitable contributions tend to decline.

Outlook 2009

Although annual data for 2009 are not available, surveys have been conducted regarding how charities are faring. A summary report has been published by the National Council of Nonprofits.⁵² This overview provides information suggesting nonprofits continue to feel the pressures of increased demand for their services coupled with decreasing revenue. More than a third of nonprofits have had to cut operations. The surveys, particularly several state surveys, cite reduced support from governments as more problematic than reduced support from individual and foundation giving (corporate giving is also cited as declining significantly). Although all three levels of government (federal, state, and local) are mentioned, it is primarily state support that is falling. In addition to funding cuts, states apparently have been delaying payments for services they have contracted with nonprofits to provide. One study, from Connecticut, is specifically focused on contract payment delays.⁵³ One national survey found that 35% of respondents reported declines in government support and 37% reported delayed payments from the government.

Some additional funds for charitable activities were provided in the 2009 federal stimulus plan, many of these funneled through state and local governments. The additional funding was summarized in a publication by the National Council of Nonprofits.⁵⁴ Overall, however, it appears that governments, particularly state governments, may be contributing to the financial difficulties of nonprofit organizations, even to the point of not paying for contracted services.

The Charitable Sector's Relationship with Government

Various charitable activities are subsidized by the federal tax code or funded via government grants. In order to understand the rationale for government support of the charitable sector, it is important to understand the economic theories relevant for charitable activities.

reported by NACUBO, <http://finance.senate.gov/hearings/testimony/2007test/092607testjg.pdf>. CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples.

⁵¹ See CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples.

⁵² See <http://www.councilofnonprofits.org/files/Special%20Report%208%20-%20A-Respectful-Warning-Call-to-Our-Partners-in-Government-The-Economic-Crisis-Is-Unraveling-the-Social-Safety-Net-Faster-Than-Most-Realize.pdf>.

⁵³ See http://www.ctnonprofits.org/ctnonprofits/sites/default/files/fckeditor/file/policy/advocacy/HowLatePaymentsHarmNonprofitProviders_0509.pdf.

⁵⁴ See [http://www.councilofnonprofits.org/files/Special%20Report%201%20%20Overview%20\(Feb%202023%20FINAL\).pdf](http://www.councilofnonprofits.org/files/Special%20Report%201%20%20Overview%20(Feb%202023%20FINAL).pdf).

Market Failures: Justifying the Subsidization of Charities

There are two types of market failures used to justify government subsidization or support of the charitable sector. The first is the notion of public goods. Generally, the free market will provide too few public goods, due to the free-rider problem. Government intervention can help by increasing the quantity of public goods provided. The second relevant market failure is externalities. An externality is an outcome of a transaction whereby the market participants do not face the full cost or benefit of their actions. Each of these market failures is discussed in the context of the charitable sector in the following sections.

Public Goods

Pure public goods are characterized by two properties: the fact that they are non-rival and non-excludable. For a good to be non-rival, one person's consumption of the good does not diminish another's ability to consume that same good. For a good to be non-excludable, it is either impossible or prohibitively expensive to prevent consumption of the good once the good has been provided. One example of a pure public good is clean air. The market itself is unlikely to provide a public good due to the free-rider problem. Once a public good, such as clean air, is provided, it is available for everyone to enjoy. Since individuals know that the pure public good, such as clean air, will be available to them once provided they may wait for others to provide the good and not contribute themselves. Without contributions, the good is not provided.

Just because a good has the characteristics of a public good, it does not mean that this good will not be provided (at least partially) by the private market. In some cases, one person's demand for a good may be high enough that they are willing to provide the good on their own. Once provided, the public good is there for all to enjoy.

Individuals also tend to give more towards providing public goods than standard economic models would predict.⁵⁵ This happens to the extent that individuals are altruistic, and care about the well-being of others in addition to their own well-being. Altruism, and the well-being that individuals get from giving, motivates people to give both time and money to causes like religious organizations, disaster relief, local charities, educational institutions, and research causes among others. Economists have also postulated that the warm glow model can be useful in explaining why individuals give to charity.⁵⁶ In the warm glow model, individuals not only care about the total amount of the public good provided, but also about their individual contribution to the total. Individuals are expected to contribute to a charitable cause up to the point where their contributions cease to make them better-off. Even under a warm glow model, economists expect public goods to be underprovided, since individuals do not take into account the positive external effects of their contributions.

Individuals may be motivated to give to charitable causes to the extent that their own well-being depends on the well-being of others in society. Here, redistribution has the potential to make all members of society better off.⁵⁷ In this sense, increasing the consumption of the poor can be viewed as a public good. Redistribution can improve everyone's well-being, but the optimal level of redistribution is not likely to be achieved by the market absent government intervention, due to the free-rider problem.

⁵⁵ Standard economic models assume that rational individuals are selfish and utility-maximizing.

⁵⁶ Jonathan Gruber, *Public Finance and Public Policy* (New York, NY: Worth Publishers, 2007).

⁵⁷ It was shown that income redistribution could make everyone better off by Harold M. Hochman and James D. Rogers, "Pareto Optimal Redistribution," *American Economic Review*, vol. 59, no. 4 (September 1969), pp. 542-557.

To the extent that charitable goods and services are underprovided by the market, government subsidization of charitable activities (or government provision of goods and services provided by charities) can increase overall well-being. The government supports charitable organizations that provide public goods in two major ways. First, the government provides grants directly to charitable organizations providing public goods. Second, the government provides tax breaks to charitable organizations providing public goods.

Externalities

The second rationale for government intervention via the charitable sector is the case of externalities. A number of activities in the charitable sector are associated with positive externalities. With a positive externality, there are benefits to engaging in certain transactions that do not accrue to either party involved in the transaction. For example, education is thought to have positive externalities. Not only does the person receiving an education benefit, but educated people are better equipped to participate in a functional democracy. Knowledge has positive externalities to the extent it is transferred between individuals outside of the formal education setting. Health care provision may also have positive external effects. When an individual receives a vaccine against a communicable disease, not only does that individual benefit by not becoming ill, but the entire community benefits as the risk that the individual will spread the disease to others is diminished. Subsidization of organizations providing goods and services associated with positive externalities has the potential to increase society's overall well-being.

Is There an Economic Rationale for Nonprofit Hospitals?

Some have come to question whether the favorable tax treatment for some charities is justified, such as the exemption for nonprofit hospitals. In the United States, there are both for-profit hospitals and nonprofit hospitals. Only nonprofit hospitals may qualify for tax-exempt status as 501(c)(3) charitable organizations.⁵⁸ In order to qualify, the hospital must provide charity care and "community benefits." Under the community benefit standard, hospitals are judged on whether they promote the health of a broader class of individuals in the community.⁵⁹ A hospital could meet the standard by providing charity care (i.e., free or reduced-cost care). However, there is no requirement that hospitals provide charity care, and they may qualify for the 501(c)(3) charitable status by providing other types of community benefits.

Given the large loss in tax revenue associated with treating nonprofit hospitals as tax-exempt 501(c)(3) organizations, it has come into question whether the benefits provided by these institutions are worth the costs.⁶⁰ Some have argued that since hospital services are not a public

⁵⁸ Nonprofit hospitals are a highly significant portion of the charitable sector. In 2004, nonprofit hospitals held 29% of total assets and collected 42% of total revenues within the charitable sector. See Joint Committee on Taxation, *Description of Present Law Relating to Section 501(c)(3) Organizations and Summary of Sections 501(c)(3)-Related Provisions of the Pension Protection Act of 2006 and Proposed Legislative Proposals*, JCX-53-07, July 19, 2007, <http://www.house.gov/jct>.

⁵⁹ See CRS Report RL34605, *Tax-Exempt Section 501(c)(3) Hospitals: Community Benefit Standard and Schedule H*, by Erika K. Lunder and Edward C. Liu for further discussion of the charity care and community benefit standards. The report also reviews the new annual reporting requirements (Schedule H of the Form 990) placed on hospitals. Beginning in 2009, completion of Schedule H of Form 990 is mandatory.

⁶⁰ In 2002, the Joint Committee on Taxation estimated that the exemption from income taxes given to nonprofit hospitals provided a tax savings of \$2.5 billion while the ability to use tax-exempt bonds provided another \$1.8 billion in tax savings, for an overall estimate of tax savings of \$4.3 billion. If these tax preferences were removed, the federal revenue gain may be less than \$4.3 billion as behavioral changes as hospitals move to minimize the tax burden are not considered. See Congressional Budget Office, *Nonprofit Hospitals and Tax Arbitrage*, December 2006. When the value

good (a person's consumption of medical care is rival and excludable), hospitals should not be given the same tax advantage as other charitable organizations providing true public goods.⁶¹ Analysis comparing nonprofit hospitals to for-profit hospitals has found that nonprofit hospitals do provide higher levels of uncompensated care, more emergency room care and labor and delivery care, but less Medicaid care. The monetary value of community benefits provided by nonprofit hospitals is unclear, leaving open the question as to whether the favorable tax treatment is justified.⁶²

Relationship with the Federal Government

The government supports and affects nonprofits in several ways in addition to providing grants and transfers. Recently, the federal government has begun undertaking social innovation initiatives involving nonprofits. As noted above, payments and grants to nonprofits from the government represent a significant share of receipts, although the importance of the share varies by type of nonprofit, and transfers per se are small. Another significant source of government support to the charitable and nonprofit sector arises from tax benefits, provided by both federal and state governments.⁶³ These relationships are discussed below first for the federal government and then for state and local governments.⁶⁴

Estimates regarding the value of the government's relationship with the charitable sector suggest that grants amount to about \$100 billion, with the federal government supplying about 90% of the funds. Federal tax subsidies are valued to be approximately \$115 billion to \$130 billion, and state and local tax subsidies are approximately \$30 billion to \$50 billion. In sum, the government provides approximately \$245 billion to \$280 billion to the nonprofit and charitable sector via grants and tax subsidies.

Federal Government

The federal government's oversight over charities largely stems from the tax benefits provided to the sector. Nonprofit and charitable organizations are generally exempt from tax on most income, including investment income. Additionally, donations to charitable organizations are tax deductible, effectively subsidizing charitable giving.

of additional tax benefits, such as the deductibility of contributions to charitable hospitals on individual income taxes, sales tax, and property tax exemptions were included as well, the Joint Committee on Taxation estimated that the 2002 value of all tax exemptions (federal, state, and local) for nonprofit hospitals and their supporting organizations was \$12.6 billion. See Congressional Budget Office, *Nonprofit Hospitals and the Provision of Community Benefits*, December 2006.

⁶¹ Andrew Chamberlin and Mark Sussman, *Charities and Public Goods: The Case for Reforming the Federal Income Tax Deduction for Charitable Gifts*, Tax Foundation, No. 137, November 2005.

⁶² Congressional Budget Office, *Nonprofit Hospitals and the Provision of Community Benefits*, December 2006. A recent GAO report also finds that measuring the benefits provided by nonprofit hospitals continues to be a difficult task. The report is hopeful that new IRS reporting requirements for nonprofit hospitals will afford greater understanding of the extent to which nonprofit hospitals provide community benefit in the near future. See U.S. Government Accountability Office, *Nonprofit Hospitals: Variation in Standards and Guidance Limits Comparison of How Hospitals Meet Community Benefit Requirements*, GAO-08-880, September 2008, <http://www.gao.gov/new.items/d08880.pdf>.

⁶³ The federal government also provides a postal subsidy to the nonprofit and charitable sector.

⁶⁴ Many of the issues addressed here are discussed in more detail in CRS Report RL34608, *Tax Issues Relating to Charitable Contributions and Organizations*, by Jane G. Gravelle.

Recent legislation established a social innovation fund in the Corporation for National and Community Service, and President Obama has created the White House Office of Social Innovation and Civic Participation to coordinate these efforts. This program is briefly discussed before turning to a discussion of several types of 501(c)(3) organizations and issues that have been subject to recent congressional interest and the financial benefits related to taxes and the postal subsidy.

Social Innovation Initiatives

The Edward M. Kennedy Serve America Act (P.L. 111-13) enacted in 2009 established a social innovation fund that is administered by the Corporation for National and Community Service. This corporation administers domestic volunteer initiatives (such as VISTA).⁶⁵ A budget request for \$50 million has been submitted. In addition, a White House Office of Social Innovation and Civic Participation has been established to coordinate these efforts. According to White House officials the objectives of this initiative were to develop partnerships with the private sector (nonprofits, businesses, and philanthropists), support and spread innovative ideas (such as Harlem Children's Zone), support greater civic participation through media, and promote national service.⁶⁶

Foundations

Most foundations differ from operating charities in that they often have a single donor. In addition, while a gift to a foundation is deductible for income (and estate and gift) tax purposes, the funds are not immediately used for active charitable purposes. Rather, funds are invested and donations are often made to charitable organizations from earnings that may allow the corpus of the foundation to be maintained and grow. Contributing to a foundation and allowing the funds to grow allows the benefits of both the charitable deduction and the exemption of tax on earnings.

To address concerns that foundations could simply retain earnings and grow indefinitely, and because foundations are often closely tied to a family or specific group of donors, tax laws require a minimum payout rate (5%) and restrict activities that may benefit donors. The tax code imposes taxes and/or penalties for self-dealing, failure to distribute income on excess business holdings, for investments that jeopardize the charitable purposes, and for taxable expenditures (such as lobbying or making open-ended grants to institutions other than charities). There is a 1% tax on investment income of foundations, and an additional 1% penalty if the foundation does not make a certain minimum distribution (based on distributions made in the previous five years), or has been subject to a tax for failure to distribute in the previous five years.

Donor-Advised Funds and Supporting Organizations

In recent years, concerns have been raised about charitable vehicles that have some of the same features as foundations: donor-advised funds and supporting organizations. Donor-advised funds are funds where donors make contributions to the fund and the institution holding the accounts makes contributions to charitable organizations with the advice of the donor. While the donor has no legal control, in practice the donor's wishes are likely to be respected. Supporting organizations do not actively engage in charitable activities but support organizations that do by contributing funds. Supporting organizations fall into three categories: type I organizations

⁶⁵ See CRS Report RL33931, *The Corporation for National and Community Service: Overview of Programs and FY2009 Funding*, by Abigail B. Rudman and Ann Lordeman.

⁶⁶ See http://www.whitehouse.gov/the_press_office/President-Obama-to-Request-50-Million-to-Identify-and-Expand-Effective-Innovative-Nonprofits/.

directly controlled by the charitable organizations; type II organizations controlled by the same entity controlling the charitable organization; and type III organizations related to the charitable organization (these organizations may support many charitable organizations).

Donor-advised funds and supporting organizations share many features with private foundations, but have historically not been generally subject to self-dealing rules and other restrictions (meant to prevent the donor from receiving a private benefit) or payout requirements (meant to keep the organization from accumulating funds without paying out some amount for charitable purposes).⁶⁷ In an effort to address concerns that abuses were occurring and that, in some cases, little was being paid out, the Pension Protection Act of 2006 (P.L. 109-280) imposed a number of regulatory requirements and also required a Treasury study of donor-advised funds and other supporting organizations to evaluate whether they should continue to receive tax-exempt status. Donor-advised funds eligible for charitable contributions are prohibited from providing benefits to the donors, and are required to have a governance structure if grants are made to individuals (such as a scholarship fund). Contributions of closely held businesses must be sold within a short period of time. Supporting organizations must indicate which type they are and certain type III organizations will eventually be subject to a minimum payout. The Treasury Secretary was charged with determining the details of the minimum payout requirement through regulation. On September 24, 2009, the Treasury issued a proposed regulation to impose a 5% rate (which is the same rate that applies to private foundations), pending comments due in December 2009.⁶⁸ At this time, however, donor-advised funds are not subject to a payout requirement.

Endowments

Endowments also share a number of characteristics with foundations. Specifically, deductions for the contribution are made in advance of the expenditure and the endowment principal may be maintained or grow. Endowments receive tax-exempt earnings, but there is no payout requirement. In recent years the growth of university and college endowments raised concerns and led to discussions of possible payout requirements. The Senate Finance Committee received testimony on college endowments in connection with hearings held on offshore funds in 2007. Major university endowments are invested in, among other assets, offshore hedge funds, and one issue discussed during the hearing was whether these investments were being used to avoid the unrelated business income tax. The witnesses discussed the growth of endowments and also addressed the relationship between endowments and affordability, showing that a very small increase in payout of universities and colleges with the largest endowments could obviate the need for tuition increases and could fund significant increases in student aid.⁶⁹ The Senate

⁶⁷ Self-dealing rules generally prohibit direct financial interaction between a foundation and nearly all persons closely related to the foundation (disqualified persons). The IRS provides further detail regarding transactions that violate the prohibition of self dealing for private foundations at <http://www.irs.gov/charities/foundations/article/0,,id=137679,00.html>.

⁶⁸ See <http://edocket.access.gpo.gov/2009/pdf/E9-22866.pdf>.

⁶⁹ See testimony of Jane G. Gravelle, Congressional Research Service, and testimony of Lynn Munson, Center for College Affordability and Productivity, before the Senate Finance Committee, September 26, 2007, at <http://finance.senate.gov/hearings/testimony/2007test/092607testjg.pdf> and <http://finance.senate.gov/hearings/testimony/2007test/092607testlm.pdf>. Also, see the memorandum by Jane G. Gravelle, Congressional Research Service, analyzing endowment earnings, payouts, and uses that formed the basis for testimony, at <http://finance.senate.gov/press/Gpress/2008/prg011408b.pdf>.

Finance Committee also sent a survey to colleges with endowments of more than \$500 million to obtain more details about their endowments and payouts.⁷⁰

Charitable Contributions

While charitable deductions are available to all taxpayers, individuals who take the standard deduction do not use the charitable contribution deduction. (The logic behind the standard deduction is that it accounts for the tax-deductible activities of individuals choosing not to itemize deductions.) Slightly over one-third of individual taxpayers itemize; about 30% deduct charitable contributions. Individuals' contributions are, in general, limited to 50% of income for most charities, but are restricted to 30% for certain nonprofits, including non-operating foundations and institutions set up for the benefit of members (such as fraternal lodges).

Individuals can contribute property as well as cash. The contribution of appreciated assets has particularly beneficial treatment, as the value of most appreciated assets can be deducted without including the capital gains in income which would be subject to tax. (Some contributions of property are limited to the smaller of basis or fair market value, such as business inventory.) For that reason, gifts of appreciated property are limited to 30% of a donor's adjusted gross income for most general charitable donations, and to 20% for donations to organizations with more restricted giving limits, such as non-operating private foundations. Deductions for inventory property used in a business are generally limited to the cost of production and not market value.

Individuals can also deduct costs of volunteering for charitable purposes, including out-of-pocket expenditures, costs of using a vehicle, and travel costs when there is no significant personal element. In lieu of calculating costs of operating an automobile, volunteers may deduct 14 cents per mile. This amount is set by statute and is smaller than amounts allowed for medical and moving purposes (24 cents), which are in turn smaller than the amounts allowed for business purposes (55 cents). These latter rates are adjusted for changes in costs.⁷¹

Like individuals, corporations are subject to restrictions on their ability to deduct charitable contributions. For example, corporate contributions are generally limited to 10% of taxable income. In some cases, the tax code encourages the donations of certain types of property: for example, there is an enhanced deduction for donations of food inventory to organizations serving the needy.

There are a number of temporary provisions, referred to as extenders, that allow more generous tax treatment for certain contributions. The most important, in revenue terms, is the IRA rollover provision allowing individuals who are 70½ to contribute amounts in individual retirement plans directly to charity without including the distribution in income. This provision is advantageous to those who do not itemize deductions and benefits taxpayers because certain provisions (such as the taxation of social security benefits) are triggered by adjusted gross income. Other major extenders relate largely to gifts of inventory.⁷²

⁷⁰ Senate Finance Committee Press Release, "Baucus, Grassley Write to 136 Colleges, Seek Details of Endowment Pay-Outs, Student Aid," at <http://finance.senate.gov/press/Gpress/2008/prg012408f.pdf>.

⁷¹ See CRS Report R40434, *Charitable Standard Mileage Rate: Considerations for the 111th Congress*, by Nonna A. Noto.

⁷² See CRS Report RL32367, *Certain Temporary Tax Provisions Expiring in 2009 ("Extenders")*, by Pamela J. Jackson and Jennifer Teefy for a discussion of extenders. See also CRS Report RL34608, *Tax Issues Relating to Charitable Contributions and Organizations*, by Jane G. Gravelle.

A number of difficulties arise in administering the charitable deduction tax provision. For example, there is no third-party reporting to help confirm that deductions are legitimate. There are also concerns about the valuations of certain types of property, including not only gifts by the wealthy, but also gifts of vehicles and household furniture. Recent legislative initiatives have increased recordkeeping requirements and placed other restrictions on non-cash charitable contributions.⁷³

Exemption of Tax on Investment Income of Nonprofits

Direct data on the cost of the tax exemption for investment income for nonprofits are not available. The lack of tax on earnings of nonprofit organizations is not considered a tax expenditure. Consequently, the Joint Committee on Taxation does not provide estimates of the cost of this provision. In an effort to estimate the cost of the tax exemption of investment income for nonprofits two different data sources are reviewed.

The Bureau of Economic Analysis (BEA) reports for 2005, \$128 billion in dividends, interest, and capital gains for nonprofit institutions serving households. At a 35% tax rate, this would result in \$45 billion of revenue loss. This estimate does not include net rent (which is likely to represent a relatively small share) and also excludes some capital gains income of religious organizations.

Data taken from all organizations filing Form 990, including net rent, dividends, interest, and capital gains on securities, indicate \$170 billion of income for FY2006. At a 35% rate, total revenue loss is \$60 billion. For the data from the Form 990, charitable organizations with contributions deductible under 501(c)(3) accounted for 55% of the investment income, foundations about 32%; the remainder of the income is attributable to charitable organizations not exempt under 501(c)(3). Among the charitable organizations, half the investment income was received by the education sector (over a third in higher education) and about 30% in the health category.

Income from university endowments soared in recent years before declining during the recession. For FY2007, total increases of university endowments were \$88 billion; with 30% projected to be unrealized capital gains, income was about \$53 billion, as compared to the \$34 billion reported the previous year.⁷⁴ As the economy fell into recession, however, earnings fell precipitously. These fluctuations in earnings make it difficult to determine a steady state rate of growth, but had the BEA estimate increased by a normal growth rate of 5% or so per year, endowment income would be \$55 billion for 2009. Estimates using data from the Form 990 are closer to \$70 billion. In either case, the estimated cost of exempting this income from taxation exceeds the cost of the charitable contribution deduction, which is approximately \$50 billion.

The asset income estimates include foundations, supporting organizations, and endowments, but do not include donor-advised funds. The amounts in these funds are small relative to the remaining nonprofits' assets, but have been growing quickly.⁷⁵

⁷³ These issues are discussed in more detail in CRS Report RL34608, *Tax Issues Relating to Charitable Contributions and Organizations*, by Jane G. Gravelle.

⁷⁴ See CRS Report RL34608, *Tax Issues Relating to Charitable Contributions and Organizations*, by Jane G. Gravelle.

⁷⁵ Issues surrounding supporting organizations and donor-advised funds, as well as gifts of appreciated property, are discussed in the testimony of Jane G. Gravelle, on Charities and Charitable Giving: Proposals for Reform, before the Senate Finance Committee, April 5, 2005, at <http://finance.senate.gov/hearings/testimony/2005test/jgtest040505.pdf>. In 2007, donor-advised funds were estimated to hold approximately \$31 billion in assets. Council on Foundations, Inc., *Donor Advised Funds Provide the Majority of Grant Funds Awarded by Community Foundations*, January 13, 2009, <http://www.foundationsonthehill.org/docs/08donoradvisedpaper.pdf>.

As is the case with other provisions, this value of the exemption varies substantially across different types of charitable organizations. On average, charities filing with the IRS report that investment income is less than 7% of revenue. However, for higher education and supporting organizations, that portion of income is close to 20%. Investment income is 9% for arts, culture, and the humanities, but less than 3% for environment and animals, health, human services, and international. The lesser importance of investment income for health stems from the fact that the majority of the health revenue comes from fees for services (whether private or public). In health care, investment income is similar in size to charitable contributions while in the education sector investment income is about twice as large as charitable contributions. In other sectors, investment income represents a much smaller share of overall income than do charitable contributions.

The exemption of income for nonprofits and charitable organizations also interacts with attempts to provide relief or incentives for businesses that are channeled through the income tax system. For example, in stimulus proposals enacted in 2008 and extended in 2009, provisions such as bonus depreciation which were provided to stimulate investment spending were not available to nonprofits because they depended on tax liability. Similarly, proposals designed to provide relief for small businesses to help pay costs of providing health insurance for low-income employees in some versions of proposals (e.g., H.R. 3200) would not be available to nonprofits.

Charitable Contributions and Other Tax Expenditures

Table 14 provides the estimated cost of various provisions benefitting the charitable sector. The tax savings from deducting charitable contributions is estimated at approximately \$50 billion, with the majority of the costs reflecting deductions for the individual income tax. **Table 14** also provides the revenue effects for allowing nonprofit educational institutions and hospitals to issue tax exempt bonds, and the provisions exempting housing allowances of ministers from tax.

Table 14. Tax Expenditures and the Nonprofit Sector, FY2009
(billions of dollars)

Provision	Individual	Corporate	Total
Charitable contributions	46.2	3.2	49.4
Education	6.3	0.4	6.7
Health	4.0	0.3	4.3
Other	35.9	2.5	38.4
Tax exempt bonds	3.7	1.4	5.1
Education	2.1	0.8	2.9
Hospitals	1.6	0.6	2.2
Ministers' housing allowance	0.6	—	0.6

Source: Joint Committee on Taxation, Estimates of Federal Tax Expenditures, FY2008-FY2012, JCS-2-08, October 31, 2008.

In addition to the tax benefit for income taxes, there is also a charitable contribution deduction for the estate tax. This deduction is estimated at \$4.3 billion.⁷⁶

⁷⁶ Based on data in CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples indicating that \$23.2 billion was contributed, 53% of that amount was deductible, and assuming a tax rate of 45%.

Estimates for the value of the charitable contribution subsidies are provided separately for education and health. Specifically, 14% of the tax expenditures associated with allowing charitable contributions to be tax deductible accrue to the education sector, while 9% accrue to the health-oriented charities. These shares are similar to their shares of total charitable giving (14% and 7%) but are higher than the shares for individuals, which are about 11% and 4%. Foundations tend to give a larger share to education and health, 23% and 24% respectively, and account for 13% of contributions.⁷⁷

The larger shares of charitable contributions deduction benefits for education and health reflect the pattern of giving by income class. Those who itemize deductions (about 30% of returns) are in the higher income classes. Itemizers account for over 80% of contributions. **Table 15** provides data on the distribution of giving by income class. Higher-income individuals give more than the average share of contributions to health, education, and the arts, and are less likely to give to religious organizations and those providing for basic needs. For example, while only 0.2% of households have income over \$1 million, these households provide 59.1% of charitable giving to health. The 0.2% of households with income over \$1 million is responsible for 20.3% of total giving.

Table 15. Distribution of Charitable Giving Across Income Classes, 2005
(percentage of all households from income class giving to charity type)

Type of Charity	Less than \$100,000	\$100,000- \$200,000	\$200,000- \$1 million	More than \$1 million
Religious	59.4	11.3	20.8	8.6
Combined purpose (e.g., United Way)	34.8	9.8	46.1	9.3
Basic needs	49.1	12.9	27.9	10.2
Health	13.9	5.1	21.9	59.1
Education	5.9	2.5	63.5	28.2
Arts	4.4	1.9	59.3	34.4
Other (e.g., environment, international)	31.4	6.0	37.9	24.7
Total Giving from Each Income Class	35.6	7.9	36.2	20.3
<i>Addendum: directed at poor</i>	<i>41.4</i>	<i>9.6</i>	<i>34.4</i>	<i>14.6</i>
<i>Addendum: share of households</i>	<i>90.4</i>	<i>7.4</i>	<i>2.1</i>	<i>0.2</i>

Source: *Patterns of Household Charitable Giving by Income Group, 2005*, prepared for Google by the Center on Philanthropy at Indiana University, Summer 2007.

Table 15 also provides information on giving directed at the poor. The data on giving directed at the poor show the percentage of total giving focused on the needs of the poor coming from each income class.⁷⁸ Because the types of charities higher-income individuals contribute to tend to help

⁷⁷ CRS calculations based on data from The Center on Philanthropy at Indiana University, *Giving USA 2009*, pp. 3-4, 55, 67, 74, and 210-215.

⁷⁸ Based on the estimated shares of contributions in each sector going to the poor: 20% for religious, 77% for combined, 100% for basic needs, 10% for health, 16% for education, and 64% for other. The study notes that estimates of the share for religious organizations were about twice the size of some earlier estimates; if 10% were used for religious organizations, the overall share going to the poor would be about 27% and the share of those \$100,000 and under would be about 40%.

the poor somewhat less, they provide a smaller-than-average share of their contributions to the poor.

Relative to revenue, arts, culture, and humanities is likely to have the largest benefit from the tax subsidy for charitable contributions because this sector is favored by higher-income individuals and, as shown in **Figure 5**, contributions are a large share of receipts.

Most of the tax benefit from the estate tax goes to foundations (over half). Bequests are disproportionately given to education, health, and arts and culture. Foundation grants also tend to favor these types of activities.⁷⁹

Postal Subsidies

Qualifying nonprofits are eligible for reduced postal rates. In the past when the federal government appropriated funds to cover this cost, the value appeared to be several hundred million, and could perhaps be as much as \$1.15 billion today. Currently, the cost is shifted to other mailers. The provision has been criticized by for-profit competitors as an inefficient and potentially unfair way to aid nonprofits.⁸⁰

State and Local Governments

State and local governments provide benefits to nonprofits through mechanisms such as grants (as discussed above) and tax subsidies. Tax subsidies include state income and estate tax provisions similar to the federal provisions, as well as property tax and sales tax exemptions.

State and Local Tax Benefits

State and local governments provide tax subsidies for charities through income taxes (largely state tax sources, which oftentimes piggyback on the federal income tax structure), property tax exemptions (primarily local tax sources), and sales tax exemptions (primarily state tax sources). There are also state inheritance taxes.

The value of these subsidies is more difficult to determine given the heterogeneity in state tax systems and revenue sources. This is particularly true for property taxes which are collected locally, leading to greater data limitations and overall revenue uncertainty. **Table 16** provides estimates of the value of state and local tax subsidies to nonprofit organizations. Regardless of the uncertainties, the property tax exemption provides charitable organizations with the most tax savings. The property tax exemption is particularly useful to organizations with significant real property such as churches, educational institutions, housing nonprofits, and art museums. Adding income subsidies, worth approximately \$10 billion to \$12 billion, and sales tax exemptions brings the total value of state and local tax subsidies to \$30 billion to \$50 billion.

Table 16. State and Local Tax Subsidies, 2008-2009

(billions of dollars)

Provision	Tax Benefit
Exemption of investment income	7 - 9

⁷⁹ The Center on Philanthropy at Indiana University, *Giving USA 2009*, pp. 55 and 67.

⁸⁰ Postal Regulatory Commission, Universal Service Obligation Report, December 19, 2008, pp. 132-134, available at <http://www.prc.gov>. Also see CRS Report RS21025, *The Postal Revenue Forgone Appropriation: Overview and Current Issues*, by Kevin R. Kosar for a discussion of the provision.

Provision	Tax Benefit
Charitable contributions, individual	3.2
Charitable contributions, corporate	0.4
Inheritance tax	0.1
Property tax exemptions	17 - 32
Sales tax exemption	3.3
Total	31 - 48

Source: CRS calculations and Woods Bowman and Marion R. Fremont Smith, "Notes on Nonprofits and State and Local Governments," and by Evelyn Brody and Joseph J. Cordes, "Tax Treatment of Nonprofit Organizations: A Two-Edged Sword?" in *Nonprofits and Government, Collaboration and Conflict*, ed. by Elizabeth T. Boris and Eugene Steuerle (Washington, DC, Urban Institute, 2006), pp. 181-218 and 141-180.

Notes: Corporate provisions were based on increases in the corporate marginal tax by adding state and local taxes to the federal tax, which, as estimated by the Treasury Department, were 13% of the federal estimated tax benefit. The range for investment income reflects the \$55 billion to \$70 billion range cited in the text. Estimates of the tax benefit from individual provisions assumed an average marginal tax rate of 3% for state taxes and a 30% federal marginal tax which, allowing for deduction of state taxes on federal returns, indicate a state value that was 7% of the federal value. The inheritance tax was based on the ratio of state to federal tax collections. Property tax estimates were increased 33% to account for religious property. These exemptions are updated to 2008 based on revenue collections.

Potential Impacts of Government Grants on Giving

The amount of money spent on grants is not necessarily the amount of money the charities ultimately receive. With grants, there is a possibility that government grants will displace individual contributions (government funds substitute for private funds) or that government grants will lead to more private contributions (government funds and private funds as complementary).

Government Funds and Private Funds as Substitutes

Crowd-out, or charities substituting government funds for those that would have been raised privately, is an important issues for policymakers in considering funding levels for charitable activities. The level of crowding out determines how much the government must spend to increase the supply of the public good. Most economists expect that crowd-out is partial. Crowd-out would be full, meaning that each additional dollar of government spending on the public good corresponds to a dollar decrease in private funding, when individuals only care about the total amount of the good provided (as opposed to caring about where the funding for providing a good comes from). When non-contributors are taxed to provide the public good, crowd-out will be partial. Crowd-out will also be partial when there is a warm glow associated with giving.⁸¹

The empirical evidence on the existence and magnitude of crowd-out provides mixed results. A number of studies find significant, although mostly partial, crowding-out effects.⁸² Other studies

⁸¹ Gruber, *Public Finance and Public Policy*, pp. 190-195.

⁸² Bruce Kigma, "An Accurate Measurement of the Crowd-Out Effect, Income Effect, and Price Effect for Charitable Contributions," *Journal of Political Economy*, vol. 97, no. 5 (October 1989), pp. 1197-1207 found crowd-out of approximately 13.5 cents for every dollar of government funding in public radio. A. Abigail Payne, "Does the government crowd-out private donations? New evidence from a sample of nonprofit firms," *Journal of Public Economics*, vol. 69, no. 3 (September 1998), pp. 323-345 found crowd-out of approximately 50% for shelter and

find empirical evidence of crowding-in. (Crowding-in occurs when government spending leads to additional private-sector spending. Why this may occur is discussed below.) In spite of these seemingly inconsistent findings, there are some trends that appear to be emerging. The first is that the degree of crowding-out varies by charity type. While crowd-out has been found for public radio, shelter, and human services, crowd-in has been found for crime and legal-related charities; food, agriculture, and nutrition charities; and other specific human services charities.⁸³ Other work has found that government grants crowd-in donations for libraries, hospitals, scientific research, and higher education.⁸⁴ Some of this could have to do with the fact that different types of charities generally rely on different funding sources. The second is that crowding-out also depends on levels of support and where the money is coming from (what level of government). Empirical work looking at American theaters found that theaters with low levels of public support tended to experience crowding-in, while crowding-out was more common for theaters with larger levels of government support. Federal support appears to have a crowding-in effect at any level, while local support initially crowds in at low support levels but begins to crowd out at higher levels of support.⁸⁵ Considering the possibility of crowding-out is important for policymakers looking to boost charitable activity within a given sector.

Recent work has found that governments should not only be concerned with the fact that government spending can potentially crowd out private support for charities, but also that government grants can cause charities to reduce their fund-raising efforts.⁸⁶ Empirical work shows that crowd-out via reduced fund-raising is partial, but at least one study has found that crowd-out of fund-raising is greater than crowd-out of private donations.⁸⁷ There is also evidence that private contributions and fund-raising efforts both increased in the arts when the government cut funding for the National Endowment for the Arts.⁸⁸ This observation may have implications for policy. Governments providing grants to charitable organizations may want to consider matching grants, where receiving organizations are required to show increased fund-raising efforts in order to receive the grant. Alternatively, government grants could be accompanied by a maintenance of fund-raising effort clause.⁸⁹ On the flip side, when the government reduces funding to charitable organizations the loss may be mitigated by increased fund-raising efforts leading to greater levels in private funding.

human services organizations.

⁸³ Garth Heutel, *Crowding Out and Crowding In of Private Donations and Government Grants*, National Bureau of Economic Research, Working Paper 15004, Cambridge, MA, May 2009.

⁸⁴ Cagla Okten and Burton A. Weisbrod, "Determinants of Donations in Private Nonprofit Markets," *Journal of Public Economics*, vol. 75, no. 2 (February 2000), pp. 255-272.

⁸⁵ Francesca Borgonovi, "Do Public Grants to American Theatres Crowd-Out Private Donations?" *Public Choice*, vol. 126, no. 3-4 (March 2006), pp. 429-451. Care should be taken not to presume these results will hold for other charitable sectors. Nonetheless, these results do suggest that more research is needed to better understand what types of government support are susceptible to crowding out.

⁸⁶ James Andreoni and A. Abigail Payne, "Do Government Grants to Private Charities Crowd out Giving or Fund-Raising?" *American Economic Review*, vol. 93, no. 3 (June 2003), pp. 792-812. The authors find that crowd-out of fund raising efforts is greater for arts organizations than in social service organizations.

⁸⁷ James Andreoni and A. Abigail Payne, "Crowding out Both Sides of the Philanthropy Market: Evidence from a Panel of Charities," American Economic Association Annual Meeting, San Francisco, CA, 2009, http://www.aeaweb.org/annual_mtg_papers/2009/.

⁸⁸ Jane K. Dokko, "Does the NEA Crowd Out Private Charitable Contributions to the Arts?" *National Tax Journal*, vol. 62, no. 1 (March 2009), pp. 57-75.

⁸⁹ It is also possible that government grants crowding out fund-raising efforts is efficiency enhancing. If the government is able to raise and distribute funds more effectively than the charity via their own fund-raising efforts, it may be more efficient to have a greater proportion of funding coming from government grants.

Government Funds and Private Funds as Complements

At other times, the government and charities work together and their efforts to provide goods and services are complementary in nature.⁹⁰ One reason for this relationship may be that in those instances, it is more efficient for the government to hire an outside organization than to provide goods and services themselves. With large bureaucratic organizations, such as the government, providing additional services may not be cost effective. Nonprofits and charitable organizations may also have better information with respect to the needs of the communities they serve, leaving these institutions equipped to meet the needs of specific communities. The government may be more inclined to partner with nonprofit as opposed to for-profit institutions since monitoring costs are lower. Since nonprofits do not face a profit incentive, the motivation may be tilted more toward providing quality services rather than minimizing costs. When the government's relationship with nonprofit and charitable organizations is complementary in nature, it is not expected that additional government spending would crowd out private support. Over the past few decades, social welfare spending by governments has increased dramatically, while the rate of charitable giving has remained relatively constant.⁹¹ This fact alone lends support to the argument that the government and nonprofit or charitable sectors complement one another in aggregate, rather than act as substitutes.⁹²

Government funding of nonprofits or charitable activities can serve as a signal of institutional quality. In this case, when government funding to a specific charitable sector or institution increases, private funding will also increase. This observed phenomena is referred to as crowding-in. Instances where crowding-in has been observed empirically were noted above.

While it might seem that there is little consensus regarding whether government spending leads to crowding-out or crowding-in of private giving to nonprofit and charitable organizations, there are some lessons the empirical literature can provide. The main lesson is that government support can either be a complement to or substitute for private funding, depending on circumstances. Circumstances that may matter, for example, might be the initial level of funding and the source of the government spending.⁹³ Circumstances will vary across nonprofit and charitable sectors as well as across institutions within sectors. This would suggest that government grants and support to the charitable sector be targeted as the potential for crowding effects are considered.

⁹⁰ The arguments here follow those made in Dennis R. Young, "Complementary, Supplementary, or Adversarial? Nonprofit-Government Relations," in *Nonprofits & Government*, ed. Elizabeth T. Boris, C. Eugene Steuerle, 2nd ed. (Washington, DC: The Urban Institute Press, 2006), pp. 37-79.

⁹¹ C. Eugene Steuerle and Virginia A. Hodgkinson, "Meeting Social Needs: Comparing Independent Sector and Government Resources," in *Nonprofits & Government*, ed. Elizabeth T. Boris, C. Eugene Steuerle, 2nd ed. (Washington, D.C.: The Urban Institute Press, 2006), pp. 81-106.

⁹² While the relationship between nonprofits and government may be complementary in aggregate, this is not to say that the activities undertaken by individual charitable sectors are not crowded out by increased government spending. For example, an increased government role in providing for the elderly via Social Security and Medicare may have reduced the need for private assistance that might have occurred. While this could be interpreted as crowding-out, it has been argued that this should be interpreted as a reorientation of nonprofit activities. The government provision of these services may free privately provided charitable funds to be used for other purposes. If the proportion of personal income going to charities remains constant, there is no aggregate crowd-out of charitable contributions flowing to nonprofit and charitable organizations.

⁹³ Francesca Borgonovi, "Do Public Grants to American Theatres Crowd-Out Private Donations?" *Public Choice*, vol. 126, no. 3-4 (March 2006), pp. 429-451 reviewed the literature on crowding and conducted an institutional-level study exploring the impact of public funding on total funding at American theaters. His evidence suggests that when public support levels are low, additional support may have a crowding-in effect. As the level of government support increases, there is a shift from additional government support having a crowding-in effect to a having a crowding-out effect. Further, it is observed that crowding-out depends on the source of government funds (federal, state, or local).

Taxes and Charitable Contributions

The effect of tax subsidies provided to charitable contributions on giving depend on the extent to which the tax subsidies induce additional charitable giving. If tax subsidies do not induce additional charitable giving, the subsidy provides a windfall to the taxpayer (without providing additional funding to charitable organizations). It is useful for policymakers to understand how much charitable giving is induced by the tax code, and the revenue losses associated with these provisions.

The relationship between the amount of contributions and the revenue cost of the subsidy depends on the price elasticity of giving. The price elasticity of giving is defined as the percentage change in quantity given divided by the percentage change in price (in this case, the price of charitable giving is $1 - t$, where t the marginal tax rate). This relationship is always expected to be negative, as an increase in the price of giving (decrease in tax rate) should be associated with decreased giving. Since the relationship is expected to be negative, elasticities here are referred to in absolute value. If this elasticity is less than one (in absolute value), the induced giving will be less than the cost of the charitable contribution deduction. When this is the case, more funds for the charitable sector could be generated by spending government funds using alternative means, such as grants (absent crowding-out). The most recent estimates of the price elasticity of charitable giving by living individuals (inter-vivos giving) suggest that the elasticity is below one. A recent CRS report uses a value of 0.5 as a central estimate.⁹⁴ This price elasticity suggests that a dollar of revenue loss induces \$0.50 of giving. Therefore, the \$50 billion of loss from itemized deductions is expected to induce increased giving of \$25 billion.

Giving from estates via bequests also represents an issue of concern for charitable organizations. Giving from estates is affected by both the estate tax rate and the wealth of individuals. The percentage change in giving relative to the estate tax rate is the price elasticity. Empirical evidence tends to suggest that the price elasticity in giving from estates is greater than one.⁹⁵ This suggests that the giving received by charitable organizations from estates exceeds the revenue loss from allowing the tax deduction. Revenue losses from allowing estates to deduct gifts are relatively small, about \$4 billion annually.

Policy Considerations

This section considers a variety of policy issues, drawn from a number of sources. Some of these issues stem from current and past legislative proposals, others arose during current debates, and still others are the result of this report's findings. Given the size and diversity of the nonprofit and charitable sector, an exhaustive list of policy options is not feasible. Instead, some of the most legislatively relevant have been presented below.⁹⁶

⁹⁴ For a review of the economic literature on the price elasticity of charitable donations see CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples.

⁹⁵ For a review of the economic literature on the price elasticity of charitable bequests see CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples.

⁹⁶ Other relevant issues not addressed here are the charitable standard mileage rate, reviewed by CRS Report R40434, *Charitable Standard Mileage Rate: Considerations for the 111th Congress*, by Nonna A. Noto, issues pertaining to lobbying, reviewed in CRS Report 96-809, *Lobbying Regulations on Non-Profit Organizations*, by Jack Maskell, as well as those related to charitable organizations involvement in political activities, as reviewed in CRS Report R40141, *501(c)(3) Organizations and Campaign Activity: Analysis Under Tax and Campaign Finance Laws*, by Erika K.

Before considering possible policy proposals, it is useful to consider what nonprofits themselves indicate are their most important policy priorities. The Johns Hopkins Listening post project surveyed nonprofit executives focusing on children and family services, elderly housing and services, community and economic development, and arts and culture.⁹⁷

The survey results indicated the four top priorities were

- restoration and growth of federal funds in their field;
- reinstatement and expansion of tax incentives for individual charitable giving;
- federal grant support for nonprofit training and capacity building; and
- reform of reimbursements under Medicare, Medicaid, and other programs to ensure they cover the cost of services.

Other proposals that more than half of respondents identified as somewhat or extremely useful included

- expansion of tax incentives to encourage volunteering;
- student loan forgiveness for those working in the nonprofit sector;
- a credit for investment making low-cost private capital available;
- restoration of the estate tax;
- a commitment to support research and improve data on the nonprofit sector;
- expansion of national service programs like Americorps;
- replacement of the charitable contribution deduction with tax credits;
- a federal agency to represent and promote the interests of the nonprofit sector;
- strengthening of government oversight agencies;
- clarifying the community benefits standard (this issue relates to nonprofit hospitals);
- eliminating or reducing the limits on lobbying activities; and
- providing a special category of “hybrid” organizations, such as social enterprises (organizations that operate businesses but with a social mission, such as hiring the hard to employ or using the surplus for a charitable purpose).

The importance of different priorities varied by type and size of charitable organizations. All organizations considered federal funding important, while those organizations that rely on reimbursement for services considered reform in that area important. Museums considered tax provisions (restoring the estate tax and expanding charitable giving) important while community and economic development organizations considered nonprofit training and capacity development important. Small nonprofits (less than \$500,000) considered tax incentives for individual charitable giving, health insurance tax credits, and training funds important.

The Independent Sector, an organization representing the charitable community, has also provided a list of policy proposals.⁹⁸ Most of the policies indicated above were suggested in their report. Their work also included some specific tax proposals, including extending and expanding

Lunder and L. Paige Whitaker.

⁹⁷ Communique No. 11, Nonprofit Policy Priorities for the New Administration, by Lester M. Salamon and Stephanie Lessans Geller, http://www.ccss.jhu.edu/pdfs/LP_Communique/LP_Communique11_pres_sounding_FINAL.pdf.

⁹⁸ Independent Sector, Policy Proposals to Strengthen the Nonprofit Community’s Ability to Serve Our Society, January 6, 2009, http://www.independentsector.org/programs/gr/2009_Nonprofit_Platform.htm.

the IRA rollover provision, revising the excise tax on foundation income, and allowing mileage deduction rates to be the same as those of business. The Independent Sector also suggested, in addition to loan forgiveness, offering scholarships in return for a specific term of service in the nonprofit community. They proposed that loans, training, and technical assistance similar to that provided by the Small Business Administration to for-profit firms be provided to nonprofits. They also proposed relief from new funding obligations under the Pension Protection Act of 2006. Modifying lobbying rules, including allowing private foundations to support non-partisan lobbying of organizations they contribute to, was also suggested. The Independent Sector indicated that anti-terrorism restrictions may have discouraged international charity and might be revised. Proposals from the Independent Sector also emphasized that subsidies provided to employers in a health care reform should also be made available to nonprofits.

It is natural that nonprofits and charitable organizations want more support from the government. These desires should be weighed against the effectiveness and efficiency of nonprofits and other potential uses of government funding. GAO testimony suggested that improving the governance and skills, particularly of nonprofits, and collecting more comprehensive data are among the issues that might be addressed.⁹⁹ There have also been a series of legislative proposals that relate to the tax treatment of charitable contributions and organizations.¹⁰⁰ Some of these proposals expanded benefits, while others were designed to address potential abuses.

Increased Funding for Grants and Subsidies

Are federal grants for nonprofits and charities insufficient, adequate, or too generous? This type of assessment is almost impossible to make, although the questions that need to be answered are straightforward. Is the objective worthy of diversion from other budgetary purposes or diversion from private consumption and investment if financed by tax increases? Will the funds provided cause crowding-in or crowding-out of private giving? Can the objective be met more efficiently with a government program or a nonprofit one? These questions, of course, must be considered on a project by project basis. For example, evidence on crowding-out and crowding-in suggested variation by type of charity.

Are subsidies that are tied to specific features of the charity desirable compared to grants? These subsidies include existing ones, such as the postal subsidy and tax subsidies that are tied to reliance on charitable giving or investment funds, or, in the case of state and local subsidies, need for real property. Normally having benefits triggered by these characteristics might be thought to be less desirable than targeted grants, because the government can make a judgment about whether the activity is desirable. That is, the tax subsidies tend to favor education and arts, while grants tend to be more important in other charities. Moreover, while the information on crowding-in or crowding-out of grants is mixed, it largely suggests crowding-in. On the other hand, recent evidence on price elasticities suggests that the government spends more than a dollar to induce an additional dollar in charitable contributions. The government may want to seek to design policies that provide the greatest increase in revenue for nonprofit and charitable organizations with the least cost to the government. (See the discussion below for ways to increase the “bang for the buck.”)

One advantage of subsidies that are triggered automatically (by contributions, investment income, real property, or use of the mail) is that no administrative oversight is required. Moreover, some

⁹⁹ Testimony of Stanley Czerwinski before the Ways and Means Committee, Subcommittee on Oversight, “Nonprofit Sector: Increasing Numbers and Key Role in Delivering federal Services,” GAO-07-1084T, July 24, 2007.

¹⁰⁰ See CRS Report RL34608, *Tax Issues Relating to Charitable Contributions and Organizations*, by Jane G. Gravelle for a discussion of some of these proposals.

would argue that the federal government cannot easily make judgments about the value of different options or charitable objectives, leading one to conclude that a general subsidy may be in order.

It is also important to consider proposals for reform which could affect not only the level of funding, but the mix of existing funding. Since different types of charities receive different shares of their funds from different sources, policies that change incentives regarding one funding source will have a larger impact on some charities relative to others. One example would be taxing investment income for charitable organizations. Such a reform would affect university endowments. But would it be better to tax the returns of university endowments and use the revenue to expand aid for poor students or expand funding for university research grants? These types of questions prove very difficult to answer in practice.

The consequences of new initiatives can also vary across charitable sectors, and should be considered. For example, one policy proposal mentioned above is to forgive student loans for those who work in the nonprofit sector. Is student loan forgiveness for charitable sector employees a better way to benefit charities than grants or other mechanisms? Such a policy would favor charities that are more labor intensive and that tend to employ younger, less experienced workers. Is tipping the scales in favor of charities with these types of employees a desirable outcome? A similar issue might be raised about a special health insurance credit (although the issue of parity under current health care reform proposals is different).

An Oversight Agency in the Federal Government

One proposal is to provide an oversight agency in the federal government that, for example, might be similar to the Small Business Administration. Such an agency could support the nonprofit sector in two ways: conduct research and data collection and serve as an advocacy organization. Such an agency could fulfill a number of functions that are discussed in this report. It could collect data, process existing data, and provide research on the nonprofit sector to guide federal policy. It could coordinate broad government initiatives including social innovation and volunteerism. It could also collect and provide information to the public. Such an agency could also provide information on foundations and advice on grant applications (information now available but typically at a cost) and information on donor-advised funds. An oversight agency could provide outreach efforts, either free or at a small charge, to assist small nonprofits with efficient and effective organization management, including training of staff and grants for such training. It could also provide low-interest loans, similar to the Small Business Administration. Finally, an organization whose mission was to make the nonprofit sector more efficient would have a very different objective from the Internal Revenue Service, whose purpose is to enforce the tax laws.

In the survey of charitable organizations discussed above, 79.6% of respondents believed more research and data were somewhat or extremely useful (29.2% believed them extremely useful). 64.1% believed creating a government agency to represent nonprofits' interests was somewhat or extremely useful (36.4% believed it extremely useful). In addition, one of the top priorities, supported by 88.2% of respondents as either somewhat or extremely useful (51.4% as extremely useful), was federal grants for training and capacity building. All of these issues along with improved oversight could be addressed with an new oversight agency.

The main concern about such an agency is whether the benefits exceed the costs, a question that is difficult to answer. The cost would depend on whether the agency also provided grants and loans. In general, however, the cost would be small compared to tax subsidies and grants. The Small Business Administration's budget was \$923 million in FY2009 and much of the cost was

for loan guarantees; \$345 million was for disaster loans (which also cover nonprofits) while only \$20 million was for general administrative overhead.¹⁰¹ Relative to an oversight agency for the nonprofit sector, the Small Business Administration serves a much larger group of small entities, and would be likely to have higher costs.

Additionally, it is important to note that a government agency is not the only entity capable of providing information and data on the charitable sector. There are a number of other organizations and educational institutions that currently collect data and disseminate research on the charitable sector (much of their work is cited throughout this report). If other organizations and educational institutions can more efficiently collect, analyze, and report data on the charitable sector, perhaps providing more funds to these organizations, rather than creating a government agency, is an option.

An alternative to an executive agency would be a congressional committee or agency. This option may be preferable if the main objective of the proposed entity is to advocate for the health of the nonprofit sector, rather than providing some of the other functions discussed above. Or, as in the case of small business, both an agency and a committee could be considered.

Proposals to Aid Nonprofits in Economic Downturns

The nonprofit and charitable sector faces a number of challenges during economic downturns. This section addresses three issues of potential importance for the sector during periods of slow economic growth: encouraging foundations to give during downturns, encouraging states to maintain efforts and pay bills on time, and how to effectively provide funds directly to nonprofits as economic stimulus.

Foundation Grants

One observation discussed in this report is that foundations played, or could play, a stabilizing role by making more grants during recessions (or at a minimum not reducing grants). One policy option is to remove any tax impediments to foundations temporarily increasing payouts. Currently, foundations are discouraged from making large one-time grants as the excise tax on investments increases if the payout ratio falls. Currently, if a foundation's payout ratio falls from one year to the next, the foundation incurs an additional 1% tax on their investment income for that year. This disincentive could be eliminated by altering the excise tax treatment on foundation investment by going to a single rate, one that does not penalize large contributions.

Under the current system, foundations are required to payout 5% of the average market value of total assets. Allowing foundations to carryforward excess payouts to use in the future (so that if the foundation paid out 6% rather than 5% in one year, the extra 1% could be used to satisfy part of future payout requirements) could help foundations smooth giving during slow economic times. This carryforward might only be allowed in recessions. Alternatively, foundations could be given a refundable credit for a share of payouts in excess of the required amounts during recessions.

State Funding and Payments

In the recent economic crisis, states reduced funding to nonprofit and charitable organizations and in some cases were delinquent on payments. To avoid this in the future, incentives could be put in

¹⁰¹ See CRS Report RL33243, *Small Business Administration Reauthorization: A Primer on Programs*, by N. Eric Weiss

place to encourage states to maintain funding for nonprofits. An example would be to set up a fund to head off a shortfall in nonprofit funding, with receipt of funds contingent on sustaining the current level of spending and providing payments on time. It is always risky, however, to create incentives of this nature because it requires determining the base level of funding and avoiding situations where states reduce funding in advance in anticipation of a slowdown.

Having an advocacy agency in the federal government also might help address issues pertaining to state support and contract payments. If there were a spotlight on states' behaviors, especially states not making their contract payments on time, they might be less willing to address their short-term cash flow problems in this manner. An agency in the federal government might also offer low-cost loans to either states or nonprofits for cash flow stresses of this type.

Providing Economic Stimulus Funds

The principal objective of a government stimulus in a recession is to induce additional spending. Monetary expansion, which is often the first measure taken by the government, eases credit and helps to restore spending on investment goods and durable consumer goods (such as houses and cars). Fiscal policy can either provide direct spending (through government spending) or induce consumers through tax cuts. Reducing taxes increases wages and leads to spending by those working to produce the additional demand, through multiplier effects.

To accomplish the objective of increasing demand, a fiscal stimulus needs to translate into increased spending and do so fairly quickly. The demand for goods and services provided by charities increases during recessions. It is unclear, however, whether stimulus money can quickly and effectively flow through charities, simultaneously meeting the increased demand for charitable services and providing economic stimulus.

Information and administration issues limit what types of organizations are eligible for stimulus funds, including nonprofits. Since stimulus spending needs to work quickly, taking the time to identify specific recipients on a case by case basis would defeat the purpose. Funds are therefore often disbursed based on formulas and existing identification of potential recipients. This suggests that funds targeted to existing and established nonprofits are more likely to be effective economic stimulus, as opposed to funds targeted towards establishing new nonprofit or charitable organizations.

Currently, the rules of the tax code effectively provide a formula for funding for both individuals and businesses. General attributes (such as income, family size and composition, investments) trigger tax benefits. Similarly, expansions of existing programs with recipients identified by specific characteristics (income, age, disability, unemployment, etc.) can be used for transfers. The government can rely on formulas to provide funds and can identify states and to some extent local governments. Nonprofits do not generally have these mechanisms in place and are therefore not normally the recipients of automatically distributed funds. Nonetheless, policies could be established to direct stimulus funds, via grants, to nonprofits during times of economic distress.

A second object of government policy during economic downturns could be to assist those groups most impacted by the slowdown, and, indeed, programs such as expanded unemployment payments are often considered during recessions.¹⁰² Were the government able to direct funds to nonprofits, it might wish to target them in the same fashion, and direct them to specific nonprofit activities. Again, this would be administratively difficult to implement. Having a system in place

¹⁰² This objective was stated in the American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5).

where certain nonprofits were pre-registered with the government could expedite the grantmaking process when needs increase.

Even if nonprofits cannot easily be direct recipients of funds, they benefit from economic stimulus programs. Grants to state and local governments may, in part, flow through to nonprofits, and even if state funding has fallen, it might have fallen more without stimulus funds. In addition, nonprofits benefit from the overall improvement in the economy that is aided through federal fiscal and monetary policy.

Nonprofits could also be allowed investment subsidies provided to for-profit firms by providing the credit equivalent of the subsidy which they could file for using the income tax form (as was done for social security payments in 2008). Subsidies could also be provided based on number of employees or their wages. Programs could also require a certain fraction of funds to be directed to nonprofits, as is the case for the low-income housing tax credit.

The Itemized Deduction for Charitable Contributions

A number of proposals have developed over the years relating to the itemized deduction for charitable contributions. Recently, the President proposed a cap on all itemized deductions to finance health-care reform, which would have automatically affected charitable deductions and resulted in some concerns being expressed. However, a CRS report indicated the effects on charities would be small.¹⁰³ This report reviewed the evidence on price elasticities which suggests that the response of charitable contributions to tax incentives is small. It also reviewed some survey evidence and evidence on the response to matching gifts, as well as historical data, which all point to a small response as well. As noted above, more recent evidence on price elasticities suggests that charitable contribution deductions are not very efficient, in that the government spends more than a dollar to induce a dollar of contributions. Using the elasticity of 0.5, which was identified as a central estimate, a dollar of revenue loss results in 50 cents of contributions.

The itemized deduction has also been criticized because it favors the charities preferred by high-income taxpayers, who tend to be those claiming the deduction, since only about 30% of taxpayers itemize their deductions. Some have suggested allowing all taxpayers to deduct charitable contributions on top of the standard deduction or converting the deduction to a credit available to all taxpayers. Converting the deduction to a credit could be designed to be revenue neutral which would reduce the benefit for current itemizers while extending it to non-itemizers.

There are other policy options that could potentially address the concern that the current system tends to direct more donations towards charities preferred by those with higher incomes. For example, a floor on charitable contributions could be imposed. Specifically, only charitable contributions in excess of 2% of adjusted gross income could be deducted, and this deduction made available for all taxpayers. Revenue gains from such a policy could be used to finance deductions from non-itemizers or to provide grants.

Imposing a floor alone would likely raise revenue and increase the efficiency of the charitable deductions without having much of an effect on giving. According to the 2004 Statistics of Income Public Use File, 96% of contributions are made by taxpayers who contribute at least 1% of income and 88% are made by those who contribute at least 2% of income. According to the

¹⁰³ CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples.

Congressional Budget Offices Options Report, a 2% floor would raise an average of \$22 billion, per year, over the next 10 years.¹⁰⁴

There is some evidence that price elasticities are smaller for lower-income individuals, although the evidence is not definitive.¹⁰⁵ Many of these individuals' contributions go to religious organizations where donors may not be very sensitive to price. In any case, extending the deduction for non-itemizers would likely cost more than it induced in additional deductions. Converting to a credit might also reduce charitable contributions. But it could increase the equity between charitable preferences of higher-income and lower-income individuals.

Other Tax Issues

This section summarizes several other tax issues that relate to charitable contributions and organizations.

Channeling Benefits Through the Federal Income Tax System (Including Health Insurance Credits)

The use of the tax system to provide incentives or benefits generally excludes nonprofits since they are generally exempt from federal income tax. This effect occurred for the stimulus proposals to provide investment incentives, and it is also in some versions of the health reform bills (H.R. 3200). Specifically, the use of tax credits to assist small businesses in obtaining health insurance coverage for employees provides no assistance for tax-exempt organizations. Nonetheless, it is possible to provide a separate credit (or grant) for nonprofits. The current Senate Finance Committee proposal provides a credit for small nonprofits to provide health insurance for low-income employees as it did for profitable firms, although the credit rate is 35% rather than 50%. The Senate Health, Education, Labor and Pensions proposal did not use the tax system as the mechanism for health insurance subsidy.

As noted above in the discussion of economic downturns, other tax subsidies, even deductions, could be converted into equivalent credits and provided to nonprofits. Job tax credits, which have recently been proposed by some, would not automatically be available if credited against the income tax, but would be if credited against payroll taxes. For provisions that are not related to the tax structure but rather use the tax system as a convenient delivery mechanism, there might not be a reason to deny benefits to nonprofits.

Restrictions on Donor-Advised Funds (DAFs), Supporting Organizations, and Endowments

The two basic issues associated with donor-advised funds and supporting organizations are the possibility of receiving private benefits by donors and payout rates. While some changes were enacted, others remain possible. Although payout requirements are planned for certain type III supporting organizations, there are no payout requirements for donor-advised funds and for other supporting organizations. These issues might be revisited when Treasury completes its studies.

¹⁰⁴ Congressional Budget Office, *Budget Options Volume 2*, August, 2009, <http://www.cbo.gov/ftpdocs/102xx/doc10294/08-06-BudgetOptions.pdf>.

¹⁰⁵ In addition to CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples, see CRS Report RL31108, *Economic Analysis of the Charitable Contribution Deduction for Non-Itemizers*, by Jane G. Gravelle.

The Treasury was directed to study specific issues: whether deductions for contributions to donor-advised funds and supporting organizations are appropriate given the use of the assets or benefits to the donor, whether donor-advised funds should have a distribution requirement, whether the retention of rights by donors means that the gift is not completed, and whether these issues apply to other charities or charitable donors. Thus, it is possible that results of the studies could also have implications for charities in general.

As noted earlier, concerns have also been raised about college endowments, and the Senate Finance Committee received testimony on college endowments in connection with hearings held on offshore funds in 2007.¹⁰⁶ A possible legislative change might impose payout requirements on university and college endowments.

Gifts of Appreciated Property

In past years discussions were also directed at possible abuses of gifts of appreciated property, which led to some limited changes (such as disallowing partial gifts).¹⁰⁷ A more restrictive proposal for charitable gifts would be to allow only the basis (generally the cost of the property) rather than the fair market value to be deducted. The CBO estimates the revenue gain from that change to raise an average of \$2 billion per year over the next 10 years. An alternative could be to require taxpayers to sell the asset and donate the proceeds to charity. This would likely result in a revenue loss to the government but might address valuation problems. Taxpayers could avoid payment of the capital gains tax if donations were made in a timely fashion. Other approaches for valuation have included proposals for “baseball arbitration” where the court may only choose either the IRS or the taxpayer’s valuation, which would provide an incentive to the taxpayer to state a value closer to market value.

Nonprofit Hospitals

Some in Congress have also been interested in nonprofit hospitals. A major concern raised by some is the degree of charity care provided by these hospitals and whether they are providing benefits that justify their tax-exempt charitable status. The Congressional Budget Office released a study in 2006 that found that nonprofit hospitals overall provided only slightly more charity care than for-profit hospitals.¹⁰⁸ The Senate Finance Committee held hearings on the topic, “Taking the Pulse of Charitable Care and Community Benefits at Nonprofit Hospitals,” on September 13, 2006, and the House Ways and Means Committee held hearings on “The Tax Exempt Hospital Sector,” on May 26, 2005.

The following concerns have been raised about nonprofit hospitals: establishing and publicizing charity care, the amount of charity care and community benefits provided, conversion of nonprofit assets for use by for-profits, ensuring an exempt purpose for joint ventures with for-

¹⁰⁶ See testimony of Jane G. Gravelle, Congressional Research Service and testimony of Lynn Munson, Center for College Affordability and Productivity, before the Senate Finance Committee, September 26, 2007, at <http://finance.senate.gov/hearings/testimony/2007test/092607testjg.pdf> and <http://finance.senate.gov/hearings/testimony/2007test/092607testlm.pdf>. Also, see the memorandum by Jane G. Gravelle, Congressional Research Service, analyzing endowment earnings, payouts, and uses that formed the basis for testimony, at <http://finance.senate.gov/press/Gpress/2008/prg011408b.pdf>.

¹⁰⁷ These changes are discussed in CRS Report RL34608, *Tax Issues Relating to Charitable Contributions and Organizations*, by Jane G. Gravelle.

¹⁰⁸ Congressional Budget Office, *Nonprofit Hospitals and the Provision of Community Benefits*, December 2006.

profits, governance, and billing and collection practices.¹⁰⁹ In July 2007, the IRS released an interim report on nonprofit hospitals, where they found that the median share of revenue spent on charity care was 3.9% and almost half of hospitals spent 3% or less. The average was 7.4%.¹¹⁰

Another concern that has been expressed is that, since a 1969 revenue ruling issued by the Internal Revenue Service, nonprofit hospitals are no longer required to provide charity care to qualify for exempt status as a charitable organization; rather they must meet a “community benefit” standard that does not require charity care and is not precisely defined.¹¹¹

Extenders

As discussed above, there are several charitable provisions that are temporary, with the major one being the IRA rollover deductions.¹¹² Whether to extend, make permanent, or expand this treatment is one policy issue. Some might argue that there is no reason for providing benefits for contributions made from IRAs, but there is a benefit in having the certainty of a permanent provision. Other provisions relate to gifts of inventory and other, largely business, issues.¹¹³

The Estate Tax

A number of charitable organizations have expressed concerns about retaining the estate tax. The estate tax rates were reduced and the exemptions increased in 2001, although those tax changes are scheduled to expire in 2010, and then revert to the levels prior to the 2001 tax changes. President Obama has proposed to maintain the estate tax permanently at current rates and exemptions. The empirical evidence suggests that the response of bequests to tax incentives is larger than that of lifetime giving and that charitable contributions could fall. If so, the charitable deduction for estate taxes is an efficient method of providing benefits, but, of course depends on the retention of the estate tax and the magnitude depends on its features.¹¹⁴

¹⁰⁹ Tax Exempt Hospitals: Discussion Draft, at <http://finance.senate.gov/press/Gpress/2007/prg071907a.pdf>.

¹¹⁰ Internal Revenue Service, Hospital Compliance Program Interim Report, at http://www.irs.gov/pub/irs-tege/eo_interim_hospital_report_072007.pdf.

¹¹¹ See CRS Report RL34605, *Tax-Exempt Section 501(c)(3) Hospitals: Community Benefit Standard and Schedule H*, by Erika K. Lunder and Edward C. Liu for further discussion of the legal issues involved in defining community benefit.

¹¹² For further information see CRS Report RS22766, *Qualified Charitable Distributions from Individual Retirement Accounts: A Fact Sheet*, by John J. Topoleski.

¹¹³ See CRS Report RL34608, *Tax Issues Relating to Charitable Contributions and Organizations*, by Jane G. Gravelle

¹¹⁴ This issue is discussed in CRS Report R40518, *Charitable Contributions: The Itemized Deduction Cap and Other FY2010 Budget Options*, by Jane G. Gravelle and Donald J. Marples.

Appendix.

Table A-1 contains data on the sources of revenue across various sectors of charitable organizations. This data was used to generate **Figure 5** in the text.

Table A-1. Revenue by Source, 2005

(billions of dollars)

Charitable Sector	Private Contributions	Private Payments	Government Grants and Payments	Investment Income	Other Revenue	Total
Arts, culture, and humanities	9.62	6.61	2.83	2.09	1.52	22.67
Education	23.89	106.32	23.03	32.24	4.31	189.79
Higher education	16.33	86.27	16.90	28.92	3.17	151.58
Other education	7.56	20.04	6.13	3.32	1.14	38.20
Environment and animals	5.04	2.50	1.28	0.78	0.93	10.51
Health care	16.20	379.14	245.51	19.73	11.92	672.50
Hospitals	7.55	280.85	206.38	14.62	9.56	518.96
Other health services	8.65	98.29	39.13	5.10	2.36	153.53
Human services	22.61	59.01	52.05	3.82	5.80	143.29
International	14.29	1.12	3.95	0.38	0.11	19.84
Other operating public charities	9.08	14.06	12.81	3.63	1.19	40.77
Supporting public charities	43.05	21.22	9.56	18.25	4.60	96.67
Total	143.77	589.97	351.01	80.91	30.38	1196.04

Source: Wing, Pollak, and Blackwood, *The Nonprofit Almanac 2008*.

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